As Bruce Springsteen wrote in his recent autobiography, "Rock and roll bands that *last* have to come to one basic human realization. It is: the guy standing next to you is more important than you think he is. And that man or woman must come to the same realization about the man or woman standing next to him or her, about *you*. Or everyone must be broke, living far beyond their means and in need of hard currency. Or: both."

Vince Lombardi, pointed to the same sort of thing when he said, "Individual commitment to a group effort-that is what makes a team work, a company work, a society work, a civilization work."

We mean to continue to build Markel (read Green Bay Packers or E Street band, whatever you prefer) into one of the world's great companies and we mean it to last. We've successfully sustained and grown this business through 3 generations of family leadership and now our first generation of non-family management.

We've done that by following the Springsteen principle of understanding that the people next to us in this organization are more important than we think they are and in Lombardi fashion, we as individuals pour ourselves out completely in order to be worthy of mutual respect from others. This "band" of Markel includes all of our associates as well as our customers, channel partners, communities, and shareholders.

The challenges of the future (and there are always challenges) involve technology, speed, and hyper competition. Those factors will never go away. In fact they will probably accelerate and intensify as time goes by. That said, our secret weapon will continue to be the humane trust and interconnectedness that allows each of us to operate as a group that will accomplish far more than what we could as individuals.

Our long term financial performance reflects the underlying reality of personal relationships and business excellence that motivate us to continue to dedicate ourselves to each other.

Thank you for your longstanding support and partnership of this unique organization. We look forward to the years to come.

Respectfully submitted,

The Band

Alan I. Kirshner, *Executive Chairman*

Thomas S. Gayner, *Co-Chief Executive Officer*

Anthony F. Markel, *Vice Chairman*

Richard R. Whitt, III, *Co-Chief Executive Officer*

Steven A. Markel, *Vice Chairman*

F. Michael Crowley, *Vice Chairman*

## *TO OUR SHAREHOLDERS*

After being privately owned for 56 years, Markel Corporation completed its initial public stock offering in December 1986. In this, our first annual report as a public company, we will try to give you an overview of the Corporation, our 1986 results, and our plans and goals for the future.

Prior to our public offering, Milton and Stanley Markel resigned as Chairman and Vice-Chairman of the Board, respectively. They will, however, continue to serve in an advisory capacity. Milton and Stanley joined Markel over 50 years ago and their knowledge and expertise has contributed significantly to our success.

Soon after the public offering, we expanded our Board of Directors by electing V. Prem Watsa and Stewart M. Kasen as Directors. Mr. Watsa is the principal of a prominent Toronto based investment counseling firm and is Chairman of the Board of Markel Financial Holdings Limited, an affiliated Canadian corporation. Mr. Kasen is President and Chief Executive Officer of Thalhimer Brothers, Inc., a leading department store chain based in Richmond, Virginia. We are honored that Messrs. Watsa and Kasen have agreed to serve on our Board and look forward to their advice and counsel in the years to come.

In 1986, our financial results were the best in our history. Total operating revenues increased to $33.3 million, an increase of 45% over 1985. Income before realized investment gains totaled $4.7 million as compared to $899,000 in 1985. Net income was $5.0 million as compared to $1.0 million in 1985. On a per share basis, income before realized investment gains was $1.52 in 1986 as compared to $0.27 in 1985. Net income per common share was $1.61 in 1986 and $0.32 in 1985. The 1986 results include a gain on the sale of real estate of $0.17 per share.

Our 1986 results demonstrate the advantage of our corporate strategy of specialization and diversification. Three of our operating divisions experienced excellent results. The fourth, our claims administration operation, had disappointing results, reporting a net loss in 1986. We are convinced, however, that this segment of our business has a promising future and are very pleased that Edmund Langhorne has joined us as President of our claims division.

The insurance marketplace remained very tight throughout 1986, with price levels increasing and some lines of coverage difficult to obtain. This market contributed to our excellent results as we were able to obtain increased prices with less competition. While the insurance industry is now demonstrating signs of recovery, we do not expect a significantly different marketplace in 1987.

Our strategy for the future is to continue applying the principles that have proven successful for us in the past. We are a marketing oriented insurance organization. We focus on customer needs and solving customer problems. To do this effectively, we specialize in unique market niches where our expertise enables us to be the very best.

The success of this marketing strategy relies on the unique technical skills and performance of individuals. We strive to maintain an atmosphere conducive to personal growth and achievement which proves beneficial to the individual employee and to the Corporation.

We expect to continue the growth and development of each area of our operation, to supplement this growth by developing new specialty products and to look for and take advantage of acquisition opportunities.

Our long range goal is to continue our growth at a rate of at least 20% per year and to earn an annual return on equity in excess of 20%. While this is an ambitious goal, and one that few companies actually achieve, it is one we will diligently work toward.

We wish to thank each of our shareholders for the vote of confidence you have expressed by your purchase of Markel Corporation stock. As shareholders ourselves, we can assure you that we will strive to make your investment profitable.

Sincerely,

| Alan I. Kirshner | Anthony F. Markel | Steven A. Markel |
|---|---|---|
| *PRESIDENT AND CHAIRMAN OF THE BOARD* | *EXECUTIVE VICE PRESIDENT* | *EXECUTIVE VICE PRESIDENT* |

## TO OUR SHAREHOLDERS

We completed our first full year as a public company with very successful results. Once again, our diversification strategy proved valid. Our claims, underwriting, and equity investments exceeded their goals, more than offsetting the results of the brokerage division which fell short.

Net income for 1987 was $6.6 million, a 33% increase over 1986. On a per share basis, this was $1.82 as compared to $1.61, an increase of only 13% due to the larger number of shares outstanding. More importantly, our return on average shareholders' equity was 35%, well in excess of our long-term goal of 20%.

Total operating revenues increased 17.2% in 1987, reaching $39 million. Operating income was $6.9 million, a 31.3% increase over 1986. After tax, but before realized investment gains, income was $6 million, or $1.65 per share as compared to $4.7 million, or $1.52 per share in 1986.

The results of our brokerage operation were somewhat less than we had hoped, as revenues were flat and several products were down due to increased rate competition. We earned significant contingent commissions in 1987, as the result of placing profitable business in prior years. Unfortunately, contingent commissions are difficult to predict and we cannot plan for them in the future.

Our claims operations completed an excellent year with revenues increasing 13%, to $11.3 million. More importantly, most of this increase was reflected in the bottom line as we reversed the loss shown in 1986.

The insurance underwriting operations experienced continued success in 1987, as earned premiums grew 41% to $13.4 million and underwriting results remained quite good. The Essex Insurance Company expanded its base of operations and is now authorized to do business in 44 states and the District of Columbia and is represented by 70 producers. Markel American Insurance Company was licensed in Virginia and is now in business.

Markel owns a 21.6% equity interest in Fairfax Financial Holdings Limited, a Canadian holding company based in Toronto. Fairfax owns Markel Insurance Company of Canada, the oldest and largest specialty insurer for the Canadian trucking industry; Sphere Reinsurance Company, a specialty company in the reinsurance of Canadian property risks; and a 53% interest in Morden & Helwig, the largest independent claims administration firm in Canada. Our equity in the earnings of Fairfax was $1.6 million in 1987, as compared to $1.2 million in 1986.

On December 14, 1987, Markel and Morden & Helwig acquired Lindsey & Newsom Insurance Adjusters, Inc., headquartered in Tyler, Texas. Our objective is to develop a full service international claims adjusting and claims management operation. Bob Irwin, President, built Lindsey & Newsom into the leading claims operation in Texas and will be instrumental in leading the project to merge our various claims operations. Our growth potential in this business is significant and we look forward to an exciting future.

On December 29, 1987, after months of negotiation, Markel and Fairfax each purchased 35% of Shand Morahan and Evanston Services. The Shand/Evanston Group is a leading insurance organization providing professional and product liability insurance. In 1987, earned premiums were $105.4 million and assets were $542.7 million. The group has an exceptionally strong reputation for its professionalism and we are impressed with Joe Prochaska, Chairman and Chief Executive Officer of the companies. The terms of this acquisition were very favorable, and we are excited about the potential returns from this investment.

When you review our balance sheet, you will note some very significant changes from last year. Our investment in the Shand/ Evanston Group ($4.9 million) is shown as an increase in "Investments in unconsolidated subsidiaries." This investment will be accounted for on an equity basis which means we will only report our equity in the earnings of this investment. We, of course, expect this to be quite healthy.

Our investment in Lindsey & Newsom is accounted for by consolidating its results with ours. This is due to the fact that we own or control more than 50% of this operation. Therefore, our December 31, 1987 balance sheet includes the accounts of Lindsey & Newsom. One particular item to note is goodwill in the amount of $5.9 million. This represents the first time we have ever shown goodwill, reflected on our balance sheet as "Excess of cost over fair value of net assets acquired." Because the claims business is a service business, with relatively low capital needs, good cash flow, and low book values, the acquisition of strong companies in the claims business must be made at prices in excess of book value.

One additional comment about the balance sheet is in order. To finance the two acquisitions, we have borrowed $12 million, at what we believe to be very favorable terms. We are generally adverse to carrying a significant amount of debt and our goal is to repay it as soon as possible.

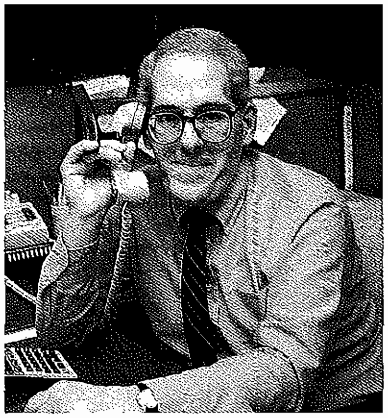
In managing our business, we focus on Marketing, Human Resources and Financial goals. This past year we restated these goals in the form of our Corporate values, "The Markel Style." While our organization enjoys the talents of a diverse group of individuals, we share the same goals and corporate values—our commitment to success. We have included "The Markel Style" in this annual report because we believe these ideals and standards set us apart from the crowd.

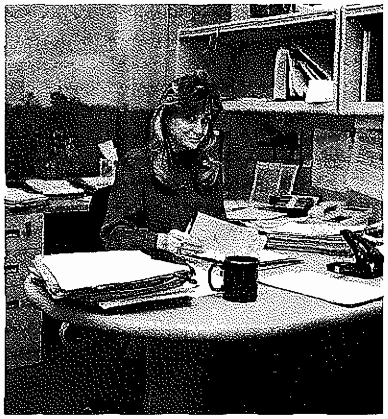
During the past year we have met with numerous investors. One of the most frequently asked questions is, "What can go wrong?" In managing our business we always try to minimize the downside risk, but, unfortunately, it is impossible to eliminate all risk.

The three most significant risks on which we are constantly focused are the insurance cycle, estimating loss reserves, and that associated with expansion to help achieve our growth objectives.

The insurance industry has historically been very cyclical, with insurance rates rising and falling to levels unrelated to actual costs. Rates increased dramatically in 1985 and 1986, and coverage was often difficult to obtain. The cycle is now moving in the other direction with insurance rates falling and competition increasing. To deal with these cycles, our continuing strategy is to specialize in diverse areas of the insurance market. By specializing, we seek to become the market leader in unique niches of the business. We believe, by participating in claims, brokerage and underwriting, and by focusing on diverse products, an adverse cycle will not affect all of our business at the same time.

The second major risk is in estimating loss reserves. During the early 1980s, the cost of settling claims escalated to unexpected levels. Many companies learned that they had significantly underestimated actual costs and that their price levels were inadequate. In extreme cases, companies found themselves bankrupt. More often, future earnings were penalized as companies increased loss reserves. To deal with this problem, we try to be as conservative as possible in reserving for our claims. We take advantage of both internal and external actuarial advice. As a result, our historic performance in estimating losses has been good and we believe our reserves are more than adequate.





The third area of risk is that the company is planning to grow, and is always looking at new opportunities. Unfortunately, there is always risk associated with expansion. We believe the greater risk is to stand still. We will work to minimize the risk of growth and expansion and plan to absorb the recent transactions before stepping out again.

Our board of directors was expanded in 1987 with the addition of Edmund G. (Ned) Langhorne, President of National Claims Service, Inc., and Leslie A. (Les) Grandis, a partner in McGuire Woods Battle & Boothe, our corporate counsel. Ned joined the Company in October 1986, and has successfully turned our claims operations around. Les was an important advisor when we went public in late 1986, and led us through a series of legal mazes in completing the two acquisitions in 1987. We welcome both Ned and Les to the Board and thank them for their contributions to the Company.

We are pleased and proud of our 1987 results. Our financial goals will continue to be increasing revenues by 20% and earning a 20% return on equity over an extended period. Our return, and yours, comes from enhancing the value of the Company—because we, like you, are shareholders.

We recognize that our achievements are made possible by the support of our customers, agents, suppliers, shareholders, and most importantly, our people—the nearly 700 men and women of Markel who share our commitment to success and whose dedicated efforts will continue to make a difference in future accomplishments.

Sincerely,

Alan I. Kirshner
*PRESIDENT AND CHAIRMAN OF THE BOARD*

Anthony F. Markel
*EXECUTIVE VICE PRESIDENT*

Steven A. Markel
*EXECUTIVE VICE PRESIDENT*

We are pleased to report exceptional results for 1988. Total operating revenues increased by 78%, to $69.5 million. Net income was up 68%, to $11.1 million, and net income per share was up 54%, to $2.80. These results represent a return on average shareholders' equity of 31%, once again exceeding our long-term goal of earning 20% on equity. Markel's strategy of diversifying into different segments of the insurance industry (brokerage, claims and underwriting) and specializing in unique product niches has again proven to be successful.

Our brokerage operations had good results with total revenues increasing by 8%, though growth in this area was limited by the soft insurance market. Transportation and animal mortality revenues were down due to severe price competition. However, revenue from all other product lines increased. Our strategy of diversification and specialization minimized the effects of the prevailing soft market. Additionally, the Law Enforcement Liability book of business acquired from Special Risks, Inc. in October 1988, contributed to fourth quarter results. With this acquisition, along with further market penetration in other product lines, we expect 1989 to be an even stronger year for the brokerage operations.

The claims operations reported revenues of $29.8 million, up from $11.3 million last year, largely as the result of our acquisition of Lindsey & Newsom in late 1987. During 1988, we made a great deal of progress in consolidating the operations of Lindsey & Newsom, National Claims, and Gordon Boyd. Effective January 1, 1989, these companies were merged into one organization under the name Lindsey & Newsom Claim Services. Through several acquisitions and internal expansion the claims operation moved into 6 new states with 18 additional offices during 1988. Lindsey and Newsom now operates in 30 states through 130 offices. While we have made significant strides in developing a strong, quality, full-service claims operation, much remains to be done. The profit margins in this area have been impacted by the costs associated with the amalgamation and expansion program. However, we remain very optimistic about the future of Lindsey & Newsom and the claims business.

The insurance underwriting operations have continued to provide both growth and profits for the Corporation. Earned premiums increased 48%, largely due to expansion into additional states and the appointment of new agents. The combined loss and expense ratio was 84%, which was significantly better than our goal and the majority of the insurance industry. We have always tried to be very conservative in establishing our estimates for loss reserves. This strategy proved beneficial in 1988, as reserves set in prior years have proven to be redundant. Without the benefit of this redundancy our combined loss and expense ratio would have been 95%, which is still quite good and well within our objectives. We believe the reserves established at year-end 1988, are conservative, though any future benefits are difficult to predict. The insurance market continues to be very competitive and while we expect to see continued growth (albeit more slowly) and profitability, we do anticipate smaller margins as the combined ratio is likely to increase. Our goal of earning underwriting profits remains intact.

Our equity investments contributed $6.0 million to the Corporation in 1988, as compared to $1.6 million the previous year. This increase was the single most significant reason for our increased net income and is primarily due to the acquisition of the Shand/Evanston Group in December 1987. The Shand/Evanston Group maintained its underwriting disciplines and price levels, producing results which exceeded our expectations. Because the markets in which Shand/Evanston competes were impacted by the soft insurance market, earned premiums declined by 42%, to $61.5 million as compared to $105.4 million in 1987. More importantly, the combined loss and expense ratio improved from 109% in 1987, to 105% in 1988. Our objective is to earn underwriting profits and, while this will be difficult to achieve with declining premium volume, we remain committed to this goal.

Fairfax Financial once again enjoyed a successful year. Nineteen eighty-eight results were favorably affected by its investment in the Shand/Evanston Group, which more than offset several somewhat unusual items which affected 1987 results. The Canadian insurance industry, and thus the insurance operations of Fairfax, is experiencing the same competitive environment as in the United States. The claims adjusting business is not impacted by the soft cycle, allowing Fairfax's Morden & Helwig to prosper regardless of the cycle. Additionally, Fairfax has expanded its investment banking activities and completed several transactions during the year. In December 1988, we converted our convertible preferred stock into common stock. As a result, Markel Corporation's equity in Fairfax's earnings will be increased from 17% to 23% in 1989. Prospects for continued growth and profitability from this affiliate are favorable.

In June 1988, we completed the sale of an additional 650,000 shares of stock at $16.25 per share. The net proceeds of this offering were $9.6 million, which were used primarily to increase our investment in the Shand/Evanston Group. A successful offering is not possible without the investment community, and their support is appreciated. While we were reluctant to sell additional shares at a relatively low price/earnings multiple, we had an opportunity to invest the proceeds in our business at rates of return which would not cause dilution to existing shareholders. The additional capital also strengthened our balance sheet.

During the year we renegotiated our revolving credit and term loan agreement, and increased our borrowing under this facility to $15 million. We believe the interest rates and repayment terms of this facility are quite competitive and very manageable, and we are not uncomfortable with this level of debt.

Shareholders' equity, including redeemable common stock, at year end was $49.8 million, or $11.44 per share. This compares to $21.6 million, or $6.00 per share, at December 31, 1987.

In 1988, we achieved unusually good results by almost any measure. As previously stated, revenues were up 78%, net income per share was up 54%, and return on average shareholders' equity was 31%. Not only are these exceptional results, but they were accomplished in a very competitive, soft insurance cycle. We expect the insurance market to remain soft in 1989, and probably beyond. As our 1988 results were favorably affected by acquisitions completed in late 1987, we do not expect our 1989 revenue growth or net income growth to match 1988 levels. We are confident, however, that by adhering to our strategy of diversification into different segments of the insurance industry and specialization in unique product lines, we can achieve our long-term goals of increasing revenues by 20% annually and earning a 20% return on equity.

While we have grown very quickly in the past few years, we are still a relatively small company in the insurance industry. We view this as an advantage, and while we expect to continue to grow, we will seek to maintain our strategy of decentralization, allowing the key people in each of the business units to respond quickly and intelligently to opportunities in their respective market segments.

The insurance industry will continue to be cyclical and the current soft market is likely to continue for some time. However, the industry is quite large (over $200 billion in premiums) and regardless of the cycle, there will be opportunities for those who can take advantage of them. We have a group of very talented individuals capable of delivering customized products, superior customer service, and immediate response to the changing needs of our customers.

The insurance cycle has very little impact on the claims administration business, which generally responds to overall economic activity. Any occasional peaks and valleys are the result of unusual weather patterns. We now have the opportunity to develop a large, international claims organization in an industry characterized by small, local operations. The opportunity for profitable growth is very exciting and we will maintain a long-term focus on building a strong, quality claims operation.

Markel Corporation looks toward the future with optimism. In spite of the very competitive, soft market environment, we believe many opportunities for continued growth and development exist. The past few years have been marked by record financial results and we remain committed to our goal of sustaining this performance over the long term.

Our accomplishments are made possible only through the support of our customers, agents, suppliers, shareholders, and, most importantly, our people. It is our people who make the difference and deserve the credit. Their commitment is evidenced by participation, enthusiasm, and the fact that so many have chosen to share in the company's future through stock ownership. The men and women of the Markel Companies have made us successful for the past 60 years and they continue to put forth exceptional effort. Our people ***ARE*** Markel, and together we are committed to success.

| | | |
|---|---|---|
| Alan I. Kirshner<br>*President and*<br>*Chairman of the Board* | Anthony F. Markel<br>*Executive*<br>*Vice President* | Steven A. Markel<br>*Executive*<br>*Vice President* |

*The Markel way is to seek to be a market leader in each of our pursuits. We seek to know our customers' needs and to provide our customers with quality products and service.*


# TO OUR BUSINESS PARTNERS:

Nineteen eighty-nine was another profitable and eventful year for your Corporation and we are pleased to share the following highlights with you, our business partners. While some of our business units did not meet expectations, overall Corporate goals were exceeded.

For 1989, total operating revenues increased 28% to $89.8 million. Net income increased 24% to $13.8 million and net income per share was up 12% to $2.60. These results represent a return on average shareholders' equity of 24%.

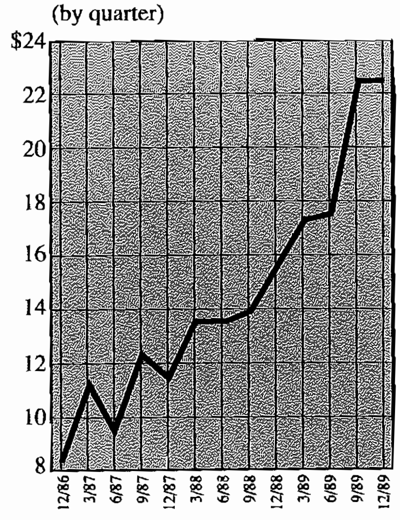
Our long-term goals remain unchanged: To achieve a 20% annual growth in revenues and a 20% annual return on shareholders' equity. For the past five years our revenue growth has averaged 39% and return on equity has averaged 30%. Since December 31, 1985, shareholders' equity has increased from $6.7 million to $64.7 million at December 31, 1989, or $1.34 per share to $11.98 per share.

## BROKERAGE OPERATIONS

In October 1989, we completed the acquisition of certain assets of the Rhulen Agency which has added several new market niches and will strengthen our position in certain agricultural markets. A major portion of Rhulen's business is seasonal, with most revenues being earned in the second and third quarters. As a result, the Rhulen Division recorded a loss in the fourth quarter and reduced our earnings by approximately $0.14 per share. We do, however, expect this acquisition to contribute to future earnings and cash flow.

Also during 1989, our leadership position in specialty municipal liability coverages continued to expand, augmented by the acquisition of a book of business from Special Risks, Inc. the previous year.

**STOCK PRICES**
(by quarter)




*Adjusted for 20% Stock Dividend 9/15/89.*

## CLAIMS ADMINISTRATION

Lindsey & Newsom continued its expansion program during 1989. At year-end, we were operating from 152 offices serving 36 states, making us one of the largest independent claims organizations in the country. In addition to expansion, our energy is also being focused on staff training and development with the goal of providing our clients with the highest quality service available in the business. This philosophy, and mission, is clearly expressed in Lindsey & Newsom's creed, "First, we'll be the Best, then we'll be First."

Despite business generated from the catastrophes of 1989, our profit margins and return on investment continue to be lower than our long-term objectives. This will continue to be true in 1990, as we are consciously investing to position Lindsey & Newsom for further growth and profitability.

## UNDERWRITING

Essex Insurance Company and Markel American Insurance Company are leaders in maintaining disciplined underwriting standards, providing unequalled customer service, and achieving exceptional results. In 1989, the Companies collectively reported a combined ratio, an indicator of underwriting profitability, of 79% on a statutory basis. More importantly, this ratio has averaged 86% for the past five years. As a comparison, the industry's average combined ratio for 1989 was in excess of 110%, and has averaged 109% for the past five years.

The insurance market continues to be in a very competitive cycle. While many experts expect pricing to stabilize in 1990 and 1991, most are suggesting the improvement will be gradual. By focusing on unique product niches and sound underwriting standards, we expect to continue our success regardless of the market cycles.

## STRATEGIC PARTNERSHIPS

Our investments in the Shand/Evanston Group and Fairfax Financial contributed significantly to our results for 1989, largely due to exceptional investment performance. The investment portfolios of these Companies, as well as the equity portfolio of Essex Insurance Company, are managed with a disciplined value orientation by Hamblin Watsa Investment Counsel, based in Toronto.

Each of our business units operates autonomously. Though synergy among the Companies is not a priority, we are quite pleased that in 1990, the Shand/Evanston Companies and Essex Insurance Company will be participating in the underwriting of certain business generated by the Rhulen acquisition.

## FINANCIAL STRENGTH

While our primary financial goal is to earn a 20% return on shareholders' equity, we are also dedicated to maintaining a strong financial position. During 1989, the total assets of the company increased from $147.3 million to $195.7 million.

Our investment portfolio increased 31% to $66.5 million, with the majority of the funds invested in high quality fixed income investments. However, to achieve a balance in investment opportunities and because we believe better


long-term returns can be realized in the equity markets, $13.8 million is invested in equity securities.

Our investment in unconsolidated subsidiaries has increased to $38.9 million. Of this amount, $16.7 million represents our investment in Fairfax Financial. Fairfax is publicly traded on the Toronto Stock Exchange and the market value of our shares at year end amounted to $27.4 million. This amounts to $1.97 per share more than our carrying value.

As a result of acquiring the Rhulen Agency, we have increased our investment in policy renewal rights from $3.8 million to $19.1 million. Policy renewal rights represent the value attributable to expiration and renewal rights for lines of business acquired. This asset will be amortized over the next seven to ten years. While this expense will penalize our near-term earnings, we will achieve tax savings and additional cash flow.

To finance the Rhulen acquisition, we have restructured our long-term debt and increased it to $44.5 million as of year-end 1989. The restructuring involved replacing our previous $20 million revolving credit facility with a commercial paper program backed by a $70 million stand-by revolving credit facility. The facility will remain available until December 1992. At that time, the participating banks may elect to extend the revolving facility for an additional three years or convert the balance outstanding to a seven-year term loan. While we have significant credit available, we will be cautious in using it.

For any insurance company, one of the most important balance sheet items is the adequacy of the reserve for unpaid losses and loss adjustment expenses. At December 1989, our reserves amounted to $31.5 million. There is always a degree of uncertainty in establishing loss reserves and estimating the future cost of claims, many of which may not have yet been reported. We establish our reserves very conservatively and are proud that in each of the past five years, the reserves we have established have, in fact, proven to be more than adequate. While we cannot eliminate all risk from these estimates, we have a high degree of confidence that the reserve level at year-end will prove to be sufficient.

## SHAREHOLDERS' EQUITY

At year-end, shareholders' equity (including redeemable common stock) was $64.7 million or $11.98 per share. This compares to $49.8 million, or $9.54 per share for the previous year and to $21.6 million or $5.00 per share at December 31, 1987.

## LOOKING FORWARD WITH ENTHUSIASM

While our results over the past several years have been extremely good, of more importance is the future. We continue to be very optimistic about the company, our markets and our ability to achieve favorable results. Though it is difficult to predict the future, we will share some of our thoughts and expectations.

Our brokerage business should double in size as a result of the Rhulen acquisition. Clearly, our 1990 revenues will increase as a result, although the impact on net income is less clear. As previously mentioned, a large portion of the purchase price has been allocated to policy renewal rights and will be amortized over the next several years. While this represents a non-cash item, it will reduce reported earnings. As with any similar transaction, risk and uncertainty do exist. We expect the acquisition to contribute to our earnings in 1990. However, due to the seasonality of the business, quarterly comparisons with prior years will be distorted.

Growth in our claims operation will continue in 1990, as a result of previous branch expansion and openings planned for 1990. Looking even further into the future, we seek to develop a financially strong, high-quality, full-service claims operation.

We expect the current business environment to exist throughout 1990, and, therefore, forecast only modest growth for our underwriting activities. While growth may be limited, we expect our profitability to remain strong. Longer term, we expect the market to harden, and we expect to be in a position to capitalize upon it.

Our strategy is to diversify into different segments of the insurance industry and to specialize in unique product niches. This strategy provides us with the balance of different businesses throughout the insurance cycle as well as the opportunity to become market leaders. It's proven successful in the past and we look forward to the future with enthusiasm.

Alan I. Kirshner
*President and Chairman of the Board*

Anthony F. Markel
*Executive Vice President*

Steven A. Markel
*Executive Vice President*

*Markel Corporation executive officers (clockwise from top): Alan I. Kirshner, Anthony F. Markel, and Steven A. Markel.*

# To Our Business Partners:

In each year since our initial public offering in 1986, significant events have occurred which have shaped Markel's growth and development. When 1990 began we were focused on our corporate strategy of diversification in several segments of the insurance industry and specialization in certain niche markets.

This past year we were presented with a unique opportunity and took advantage of it. The result is that we acquired the remaining shares of the Shand/Evanston Group and sold our ownership in Fairfax and Lindsey & Newsom. The impact of these transactions is that our operation is now completely focused on marketing and underwriting specialty insurance. We have had a close business relationship with these companies and wish them every success in the future. Prem Watsa, Chairman of Fairfax, will remain on Markel's Board of Directors and we look forward to his continued contribution.

Shand/Evanston is one of the premier specialty insurance underwriting organizations in the country. Its largest business includes various niches within the professional liability insurance market. We originally invested in this group in December, 1987 in partnership with Fairfax and certain of Shand/Evanston's management.

Over the past three years Shand/Evanston has contributed significantly to our earnings. Additionally, during the past year, Shand/Evanston has begun underwriting many of the programs which have been developed and marketed by Markel/Rhulen Underwriters.

This "strategic evolution" has the additional benefit of simplifying our operations and organizational structure encouraging synergy between our business units and simplifying our future financial reporting.

## 1990 RESULTS

In order to better understand our financial results, it is useful to understand the various accounting and reporting issues associated with the Shand/Evanston acquisition and Lindsey & Newsom and Fairfax disposition. For financial statement purposes the transactions have been recorded as occurring on December 31, 1990. As a result, the assets and liabilities of Shand/Evanston have been consolidated with the Company as of December 31, 1990 for balance sheet purposes, while Lindsey & Newsom and Fairfax have been eliminated as of that date. For purposes of income statement presentation, Shand/Evanston's earnings continue to be accounted for as earnings from an unconsolidated subsidiary. However, since both Lindsey & Newsom and Fairfax have been divested, revenues, expenses and earnings associated with these operations have been reclassified as discontinued operations in the Company's consolidated income statements.

In 1990 brokerage operations showed significant growth primarily as a result of the Rhulen Agency, Inc. acquisition in October 1989. The contribution, while not as high as we would like, continues to be good and generates significant cash flow.

Our underwriting units continue to grow and produce very favorable results. The combined ratios for the underwriting companies were 80% in 1990 compared to 79% in 1989.

The overall decline in the stock market during the year affected the Company in three significant ways. The level of realized investment gains from our investment portfolios was much less in 1990 than in 1989. This was equally true for the portfolios at Shand/Evanston. For example, in 1989 income from continuing operations was $1.97 per share, of which $.84 was from investment gains. Of the $1.46 from continuing operations in 1990, only $.12 was attributable to investment gains. Results were further impacted by the valuation of the Fairfax shares surrendered in connection with the acquisition. In establishing the value for the shares we used the quoted market price discounted for size and certain share restrictions. The decline in market price occurring in late 1990 resulted in a $5.4 million loss. While we have recorded this loss for accounting purposes, the economic value of the transaction, which was negotiated in

August 1990, was not affected by the subsequent decline in the value of Fairfax shares. Finally, the stock market decline impacted the Company in the area of unrealized losses associated with marketable equity securities. At December 31, 1990, unrealized losses associated with our consolidated equity portfolios were approximately $10.2 million and are recognized as a direct reduction of shareholders' equity.

While these financial results are short of our long-term goals, we feel 1990 has seen Markel Corporation truly position itself for the future and are proud of what has been accomplished this year.

## BALANCE SHEET

The consolidation of Shand/Evanston has resulted in several changes to our balance sheet. The most significant of these are in the areas of our Investment Portfolio, Intangible Assets, Loss Reserves, and Debt.

**Investment Portfolio** At year end our investments totaled almost $360 million as compared to $66 million one year earlier. This portfolio and the return we expect from it represents a significant opportunity to us. In managing these assets we will seek to provide the security necessary to protect the interests of our policyholders as well as the return to provide growth for our stockholders. At year end, we had $69 million of this portfolio invested in equity securities. While we continue to believe that equities will provide the greatest long term rates of return, we also believe that the Company's financial leverage currently requires that we reduce our investment exposures to equities.

**Intangible Assets** At year end the following intangible assets were recorded on our books:

| | |
|---|---|
| Policy renewal rights | $16.4 million |
| Noncompete and nonpiracy agreements | 19.3 million |
| Goodwill | 35.8 million |
| | $71.5 million |

We recognize this represents a substantial investment in the future business prospects of the Markel/Rhulen products acquired in 1989 and the additional interest in Shand/Evanston acquired in December 1990.

The policy renewal rights are being amortized over the next nine years. However, almost 50% will be written off over the next three years. The noncompete and nonpiracy agreements will be amortized over the next four years. The result is that in 1991 we expect to expense $9 million for the amortization of these amounts. These non-cash charges will have an adverse impact on earnings. However, to the extent they are also tax deductible, they will generate significant cash savings from the associated tax benefit.

**Loss Reserves** The Company's reserve for unpaid losses and loss adjustment expenses amounted to $302 million at year end compared to $31 million at December 31, 1989. These amounts represent our best estimates of the amounts necessary to meet our obligations to our policyholders. As we have discussed in prior years, in establishing these estimates, we attempt to take into consideration all of the relevant information and actuarial methods available to us. While it will always be difficult to accurately determine such future liabilities, we have established a standard for ourselves whereby we seek to set our reserves at a level which we believe is more likely to prove to be redundant than deficient.

**Debt** The Company's long term debt amounted to $127 million at December 31, 1990 and is much higher than we desire for the long term. The debt increased in 1990 as a result of additional borrowings to complete the acquisition of Shand/Evanston as well as the consolidation of their debt.

We are fortunate to enjoy excellent relationships with our bankers and it is important that we continue to maintain their confidence. Most important however, is that the Company's cash flow is adequate to meet our repayment requirements.

Our goal is to significantly reduce the amount of debt and operate in the future with less leverage.

## PRO FORMA RESULTS

The nature and size of the Company will be significantly different in the future. While not necessarily indicative of future results, the pro forma income statements in Note 18 to the consolidated financial statements provides an indication of how the consolidated operations might have appeared had the acquisition of Shand/Evanston and disposition of Lindsey & Newsom and Fairfax occurred on January 1, 1989.

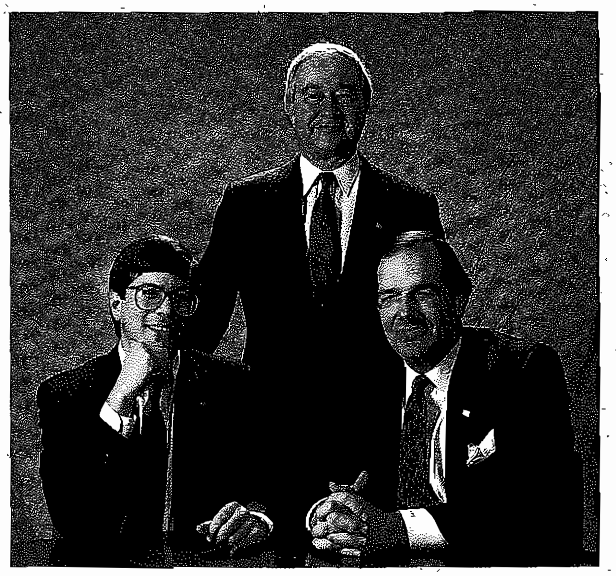
Total operating revenues would have approximated $220 million in 1990 compared to $161 million in 1989. At $145 million for 1990, earned premiums become the dominant revenue source, highlighting the underwriting focus of the Company. This focus will likely be continued in the future as our underwriting units participate to a larger extent in the business handled by our brokerage operations. With investment portfolios of $360 million, investment income will continue to be a major contributor to operating income.

As previously discussed, the non-cash expense related to the amortization of intangible assets adversely impacts income but, to the extent tax deductible, saves tax dollars. In 1990, amortization expense would have been $9.2 million. We expect these charges to continue to be significant through 1994. Interest expense in the 1990 pro forma is $16.9 million on total debt of $127 million. Interest cost on this debt is expected to be significantly less in the future due to the contractual adjustment of the accrual terms on the contingent notes at Shand/Evanston.

We are optimistic about the future given the financial opportunities presented us by our specialty underwriting focus.

**FINANCIAL GOALS**

In each of our previous reports, we have discussed our financial goals of achieving a 20% growth in revenues and a 20% return on average shareholders' equity. In our underwriting business we have always placed a higher priority on underwriting profit as it is often difficult and imprudent to grow in a period of significant price competition. While we expect to continue to grow, a much larger part of our revenues will be generated from our underwriting activity. As a result, we will not seek to maintain a 20%



Alan I. Kirshner

Steven A. Markel    Anthony F. Markel

growth rate as a financial goal.

As a result of various financial accounting issues, the Company's return on equity calculation is becoming distorted. For example, the amortization of intangibles is an expense. However, it is a non-cash expense which reflects our accounting treatment of acquisitions, not the intrinsic value of our business. Another example is our investment in equities. Accounting rules require that we recognize in our statement of income realized gains and losses while we only recognize unrealized gains and losses in our balance sheet. The result can create higher returns on equity with a decline in the value of our investments. Finally, with the additional financial leverage of our borrowings, we should earn a high return on equity.

We are developing better criteria for measuring "real return on investment" which will take these issues into consideration.

## THE FUTURE

We ended 1990 with the completion of a series of complex transactions intended to simplify our Company. Today we no longer have a complicated organization. Our business and financial structure is really quite simple. We are focused on marketing and underwriting specialty insurance. In each market we serve, we seek to provide quality products and excellent service and, as a result, to earn a position of market leadership.

We expect the strength of our marketing and sales organizations to complement our sound underwriting operations. While the insurance marketplace is likely to remain very competitive throughout the year, we believe we can continue to operate on a profitable basis in our areas of specialization with good underwriting results and good investment returns. As we focus on areas that have proven our most profitable in the past, we look forward to 1991 and beyond with enthusiasm and confidence. ■

Alan I. Kirshner
President
Chairman of the Board

Anthony F. Markel
Executive Vice President

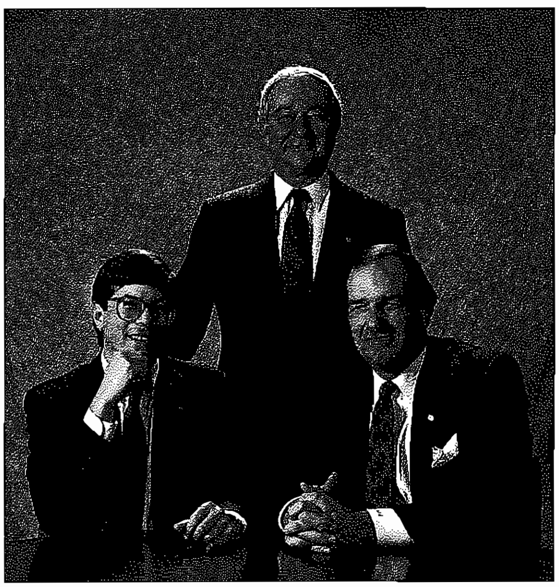
Steven A. Markel
Executive Vice President

## Dear Fellow Shareholders:

In last year's report we described Markel's "strategic evolution" which resulted in our heightened focus on marketing and underwriting specialty insurance products. This new focus began in late 1990 with the purchase of 100% of Shand Morahan and the Evanston Insurance Company.

We had previously owned a minority interest in these specialty insurance operations. Concurrent with this purchase, we sold our interests in our claims operations and Fairfax, a Canadian insurance holding company. The result was that Markel embarked on 1991 as a new company–far more focused than before and with a very simple organizational structure.

As we began 1991 we had two important short term goals. First was to improve our financial strength. This goal was achieved as we generated very substantial cash flow and reduced debt by $33 million. Our ambition is for long term debt to represent approximately 33% of our total capital. We should be very close to achieving this goal in 1992. The Company's financial strength was also enhanced by the fine performance of our investment portfolio, as market values improved and as we restructured the portfolio to improve our asset quality and reduce investment risk.



*Clockwise from top: Alan Kirshner, Anthony Markel, Steven Markel*

Our second goal was to capitalize on the opportunities provided by our new structure by leveraging the strengths offered by each of our businesses. Each company offers something different that can be utilized to the advantage of the others. The development of a unified business plan for 1992 will ensure we are working together with a common goal. Symbolic of our achievement of our second goal is the new logo which we proudly display on the cover of this report.

### A New Symbol for a Focused, Unified Markel

Prior to our "strategic evolution" we encouraged the independent and autonomous operation of each business. We now believe we should make the fullest use of our experience and expertise by making those resources available throughout the Corporation.

Today, each business unit in the Markel family is focused on marketing and underwriting specialty insurance. Quality products and excellent customer service are common themes throughout. We strive to be a market leader in each of the products, programs, and services we offer.

The demand to achieve underwriting profits is a consistent part of our planning process. We manage our operations with a common mission. Of equal importance to the mission, however, is how we get it accomplished, The Markel Style. All members of the Markel team are expected to share this commitment to success.

Our new logo with its bars ascending like our plans for the future is symbolic of the new Markel Corporation.

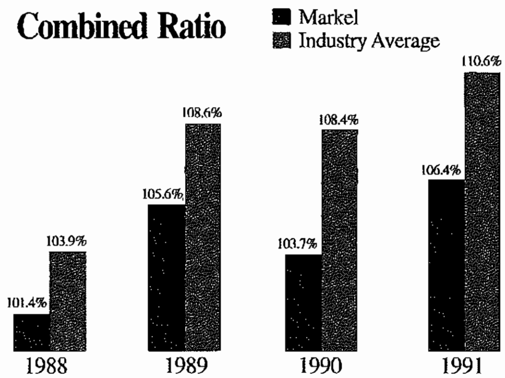
### 1991 Operating Results

We are very pleased with our 1991 financial results. Net income for the year was $14.4 million or $2.68 per share which is a record for our company.

In 1991 our total revenues were $225 million as compared to $73 million in 1990. Operating income was $38 million as compared to $14 million in 1990. We view operating income as a key indicator of our overall performance. It is a composite of underwriting, brokerage and investment results measured before amortization, interest and taxes.

In 1991 our combined ratio was 106%. When this number exceeds 100% we are operating at an underwriting loss which is contrary to our corporate objective. Our

## Combined Ratio




underwriting loss was caused primarily by one program at our American Underwriting Managers (AUM) division. In this division, we lost $8.7 million in 1991 which represented 5 percentage points of our combined ratio. This program was discontinued and the division significantly downsized by year end. We believe we have made adequate provision for any resulting losses. Unfortunately, there is no simple excuse. It is now part of our history and we will not make the same mistakes again. The good news is, of course, that the majority of our products are being underwritten profitably and on a consolidated basis, excluding AUM, we are close to achieving our goal of earning underwriting profits. We believe we can–And we will!!!

Our brokerage business provided good returns in 1991 but were slightly behind 1990 results. We view the Markel/Rhulen operation as part of our underwriting business since we retain the risk on a large part of this business. As previously reported, the Nurses Malpractice Division was sold in the first quarter of 1991 and the Governmental Programs Division in January, 1992. As a result, pure brokerage business is no longer a significant part of our business strategy.

Investment returns were very good in 1991. We enjoyed the recovery in the stock market and achieved a total return of 38% from our investment in equities. This included both gains which we realized and the recovery of unrealized losses which do not impact earnings, but are recorded as part of stockholders' equity.

Amortization expense for the year was $8.9 million. This represents a reduction to earnings per share of approximately $1.16 related to non-cash items. The majority of this amortization expense relates to items which will be fully amortized in 1994. Interest cost, primarily resulting from the financing of the Shand/Evanston acquisition in late 1990, was $11.5 million. We expect to significantly lower this in 1992 due to reduced debt levels and lower interest rates.

Return on stockholders' equity was 21% for 1991. While we are pleased with these results, we think it's even more significant that over the past five years return on equity has averaged 25%.

**Investments**

Total cash and investments were $436 million at year end. This amounts to approximately $82 per share. In early 1991 we reviewed and modified our investment policy and established new guidelines. Our investment philosophy balances the needs of policyholders with those of shareholders and recognizes the Company's financial and underwriting leverage. While we seek to earn excellent investment returns, we must first assure the adequacy of our capital so we can underwrite insurance.

During 1991 we improved the quality of our fixed income portfolio and reduced exposure to convertible bonds. Today we believe this portfolio is high quality and very liquid and will meet our future obligations to our policyholders.

The Company continues its policy of investing in common stocks, but we prudently limit our investment in equity securities in relationship to our capital base and our financial and underwriting leverage. While the greatest long-term investment returns can be achieved by investing in this sector of the market, the short term implications of this strategy are more volatility and uncertain realized gains. Total return from investing in common stocks was 38% in 1991, but over the past four years was 15%.

**Contingent Note Adjustment**

It is now five years since Fairfax and Markel originally acquired Shand/Evanston and the adjustable notes related to this acquisition are now subject to final determination. At year end our reserves reached the level at which there is, we believe, no principal or interest owing on these notes. The original sellers of the company have disagreed with our reserve estimates and we are in the process of resolving this matter. While some uncertainty exists with regard to the outcome of this process, we do not expect the results to cause any material adverse impact on our financial position or operating results.

## The Future

In each of the past several years, we have correctly forecast the continuation of the relatively soft and very competitive insurance cycle. Fortunately, our specialization in unique product niches somewhat protects us from the most competitive forces in the market.

Is this year any different? Not really. We expect the market to continue to be very competitive.

The good news is that we are certain to be one year closer to the next hard market and there are some factors which may indicate a change in the cycle. Industry pricing continues to lag. Increasing claims costs and lower interest rates should slow or even reduce the industry's investment returns.

While we look forward to the day when we will have the wind to our backs, we are extremely proud of our achievements.

Since 1986, the year Markel became a public company, we have seen earnings grow from $5.0 million to $14.4 million, book value has grown from $3.42 per share to $15.59 per share and return on equity has averaged 25%. We would obviously be pleased to achieve similar results in the next five years–and believe we will.

Markel experienced some big wins in 1991. Perhaps the most visible was the adoption of our new logo as the meshing process continued between all the Markel Companies. The resulting financial success is apparent throughout this report.

Whenever an organization is built through acquisition, it takes time to fully integrate the various operations. Integrating the talent, knowledge and expertise of the Markel people and the cultures of the new Markel companies into The Markel Style is an ongoing process that we expect to be a priority for several years to come.

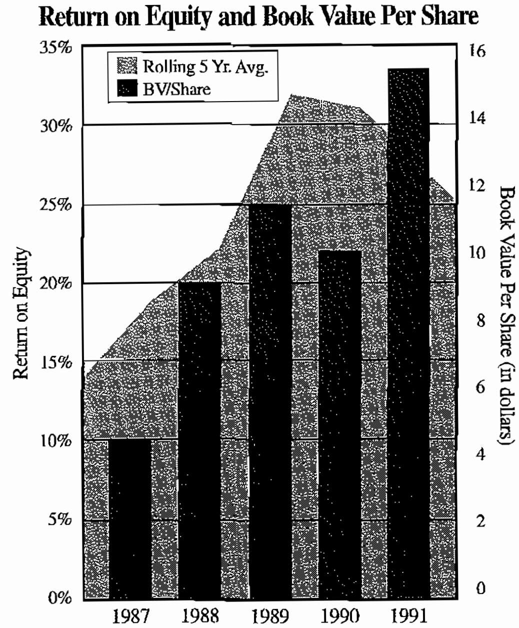
We see this as one of our best opportunities. As we work together as one organization, with common goals and a unified business plan, our future seems as limitless as the new symbol by which we are represented.

Alan I. Kirshner
*President and Chairman of the Board*

Anthony F. Markel
*Executive Vice President*

Steven A. Markel
*Executive Vice President*

**Return on Equity and Book Value Per Share**



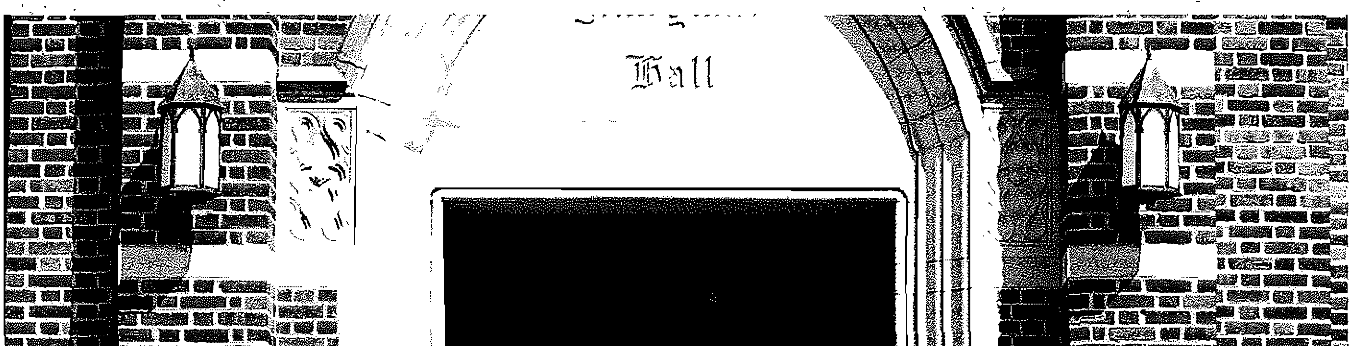
# To Our Business Partners:

We have completed another eventful and successful year. While 1992 has proven to be one of turmoil for the insurance industry, your company has avoided many of the industry's problems and is able to report excellent results. Our underwriting units achieved a 97% combined ratio and net income for 1992 amounted to $26 million or $4.64 per primary share. This represents a 27% return on average shareholders' equity. Since going public in 1986, return on equity has averaged 29% and book value per share has increased from $3.42 to $20.24.

Our primary objective in 1992 was to continue focusing on specialty underwriting and to continue unifying the various companies we had acquired in previous years. Since our "strategic evolution" in December 1990, we have substantially completed this important transition. In early 1992 we completed the sale of our Governmental Programs Division. This was a successful business for Markel and we made a very significant profit on its sale. However, the operation was primarily a brokerage business and not consistent with our strategic focus on specialty underwriting.

In April we announced our plan to move Markel Rhulen Underwriters from Monticello, New York to Richmond, Virginia. This move was completed in October and involved a tremendous effort from our entire staff. With this relocation, we will sharpen the focus on underwriting profits as well as the development of appropriate insurance company support functions. We believe this can best be accomplished in Richmond.

To better manage our growing and changing organization, the roles of the executive management team were expanded in 1992. Tony Markel, who was previously Executive Vice President for the Corporation and President of Essex Insurance Company, was made President and Chief Operating Officer of Markel




Markel Rhulen Underwriters provides student accident and health plans for over 200 colleges and universities nationwide. This program is used to ensure that every student has insurance coverage, even if they are no longer eligible for their parents' coverage.

Corporation. Tony is now responsible for all our underwriting operations and will be sure every unit remains concentrated on underwriting profits. By centralizing the management of our insurance companies, we expect to realize many efficiencies in operating and administrative activities. Product line management will remain decentralized and will not stray from our continued focus on quality customer service.

Steve Markel was promoted to Vice Chairman and will continue to have responsibility for strategic planning and investment activities. Additionally, Steve is responsible for capital allocation and loss reserve adequacy.

Darrell Martin was promoted to Executive Vice President and Chief Financial Officer. Darrell is responsible for corporate accounting, treasury and financial operations as well as most other corporate staff functions.

Alan Kirshner remains as Chairman of the Board and Chief Executive Officer. In addition to supervising corporate marketing and human resources, Alan has responsibility for internal communications. This function is particularly important as we are integrating the talent, knowledge and expertise of people from diverse cultures into the Markel "Style".

## Investments

Our investment portfolio at December 31, 1992 was $442 million. This included $290 million in fixed income investments which are purchased to assure our ability to meet our liabilities to policyholders. In 1992 we increased our investment in tax exempt securities to $116 million as yields on these securities became more attractive and our tax position made this alternative worthwhile. The investment portfolio includes $74 million in equity securities which we believe will provide us the greatest total return over the long term.

We have a larger portion of our portfolio allocated to common equities than many property/casualty insurance companies. Because of our confidence in our underwriting results, we feel comfortable with this strategy. While we believe this strategy will provide the best total return, our short term results may be less consistent because they will include capital gains and losses. Although we recognize the short term impact, we are confident our strategy will enhance shareholder value in the long term.

As we are all aware, we are now in an interest rate environment much different than any we have experienced for many years. With interest rates at such a relatively low level, it is more important than ever for us to maintain a sound underwriting discipline in order to earn our desired return on equity.

## Loss Reserves

As we have reported for many years, assuring adequate loss reserves is an on-going goal for your company.

Our loss reserves represent our best estimates of the amounts necessary to meet our obligations to our policyholders. In establishing these estimates, we attempt to take into consideration all of the relevant information and actuarial methods available to us. While it is always difficult to accurately determine such future liabilities, we have established a standard for ourselves seeking to set our reserves at a level which we believe is more likely to prove to be redundant than deficient.

At December 31, 1992 total loss reserves were $353 million compared to $346 million last year. During 1992 we realized $10 million in redundancies from prior periods. More importantly, we are pleased that in each of the past five years this has been the case.

As we reported last year, we were in dispute with regard to the contingent notes related to the acquisition of Shand/Evanston in 1987. With respect to the largest of these notes, in January of 1993 a final determination was made by an independent actuary and accountant. The good news is that, as to 1986 and prior reserves at Shand, this independent expert found our reserves to be more than adequate. The bad news is that we were required to make an additional payment on the note; however, this had no material impact on our financial results.

## Long Term Debt

Since December 1990, when long-term debt was $127 million, it has been our objective to reduce this leverage. With good cash flow and the sale of our Governmental Programs Division, we reduced long-term debt to $67 million at September 30, 1992. At that point in time debt was 40% of total capitalization...very near our goal of 33%.

In the fourth quarter of 1992 we increased borrowing by $34 million leaving debt of $101 million at year end. So what happened? We'll explain.

The Company's primary credit source has been a $70 million revolving credit facility with provisions to convert to a seven year term loan at December 31, 1992. The rate and terms of this facility are most attractive. At September 30, 1992 we had borrowed $34 million with the unused $36 million representing our available credit. In order to assure ourselves of the availability of capital on these favorable rates and terms, we borrowed the full amount available through this facility prior to converting it to a term loan.

# The Future

We opened this letter by making reference to the turmoil in the insurance industry and think it appropriate to expand on this subject. We have been in a soft, competitive insurance cycle for the past five years. In each of these years the industry has seen declining returns on equity. In 1991, the industry return declined to approximately 7% and in 1992 the numbers will certainly be worse.

In 1992 there have been an unusual number of headline stories describing problems in the insurance business. These headlines describe major losses and company reorganizations, as well as the recognition that loss reserves have often been inadequate to meet claims costs. Even some very old line, established companies experienced difficulties as a result of Hurricane Andrew's estimated $16.5 billion in losses and Hurricane Iniki hitting Hawaii.

Several companies that diversified into the insurance industry in the 60's and 70's are now exiting this business altogether. Many experienced losses for the first time in decades as a result of inadequate loss reserves, reinsurance bad debts, catastrophic losses and bad investments in real estate and mortgages.

The P&C insurance industry is truly battered and bruised!! 1992 brought big losses and sooner or later those companies most affected must return to good business judgment.

Having focused on specialty, niche marketing and having the discipline to make money as an underwriter, we've successfully avoided most of the industry's problems. But pricing has been soft and the marketplace very competitive for the past five years. Even today, with all of the industry problems, we still face a very competitive market.

## Within the negative industry headlines, there is good news for Markel

First: The significant restructuring currently taking place in the industry is likely to create new opportunities for Markel, whether it's an opportunity to underwrite a new product or to acquire a new business.

Second: Sooner or later the cycle will turn, even though it may not be as dramatic as we've experienced in the past. Shareholders will demand reasonable returns on equity. The result will be increasing prices and sound industry underwriting practices. We'll do well in this environment, too.

While these forecasts are both optimistic, our past success and our future success lies in being able to maintain focus on our mission:

- To provide quality products and excellent customer service in a variety of niche markets;
- To be a market leader; and
- To earn underwriting profits and superior investment returns.

At Markel, there is a feeling that the future we've been planning for is here.

Thank you.

Alan I. Kirshner

Alan I. Kirshner
Chairman and C.E.O.

Anthony F. Markel

Anthony F. Markel
President and C.O.O.

S.A. Markel

Steven A. Markel
Vice Chairman

A sharp-eyed shareholder noticed that this picture of Alan Kirshner flanked by Steve (*left*) and Tony Markel (*right*) appeared in both our 1990 and 1991 annual reports. He complimented the company for being "tough on costs". The photo is reprinted now to display our never-ending cost control efforts and our never-aging key executives.

# Dear Business Partners

We are proud to report another very good year. In 1993 net income was $24 million, or $4.23 per share, which amounted to an 18% return on average stockholders' equity. At year end, stockholders' equity totalled $151 million, or $27.83 per share, representing a 38% increase from $109 million, or $20.24 per share in 1992. Some of this increase was the result of a change in accounting for the unrealized gains on fixed maturity investments, which is discussed later in more detail.

## 1993 Underwriting Results

Gross premium volume was $313 million in 1993, compared to $304 million in 1992. On the surface, that's a 3% increase. However, 1992 production included approximately $18 million in premiums from sold or discontinued brokerage operations. Our core business, or "same store sales", actually increased by a much larger percentage, around 9%.

We continue to underwrite and retain a growing portion of our gross premium volume. As a result, earned premiums, which represent most of our revenue, increased 26% to $193 million from $153 million in 1992.

While we are pleased to see sustained growth in our business, we are especially pleased to report that we have again earned underwriting profits. For both 1993 and 1992, our combined loss and expense ratio was 97%, representing a 3% profit margin.

## 1993 Investment Results

Our 1993 investment results were also strong, as evidenced by a total investment return of 11%. Net investment income (dividends and interest less expenses) totalled $24 million and comprised approximately 5% of the total return, while realized gains of $16 million and unrealized gains of $16 million each accounted for approximately 3% of the total investment return.

At December 1993, the investment portfolio was $597 million, or $110 per share.

During the year, we increased our tax-exempt investments and by year-end held $164 million in state and municipal bonds. We also have continued to increase our investment in equity securities. At December 1993, we had $108 million in equity investments including $22 million in unrealized gains related to these investments. While we realize market gains when we believe it is appropriate to do so, we also recognize the tremendous power of compounding growth when we are fortunate enough to find stocks that can appreciate over many years. We believe we can benefit by sticking with good investments and deferring the tax bill.

In accordance with new accounting guidelines, at December 1993 we recorded our fixed maturity securities at fair value. In prior years, fixed maturity securities were recorded at amortized cost. The change resulted in an increase in carrying value of $12 million, and after adjustments for taxes, an increase in stockholders' equity of $8 million. While the new accounting treatment will more accurately reflect the value of our assets, it will also introduce additional short-term volatility to stockholders' equity.

## Loss Reserves

Loss reserves represent our estimate of the future cost to settle claims. We strive to estimate reserves at levels which are more likely to be redundant than deficient. In the past we have been successful in achieving this goal and believe that our reserving methods are sound.

In recent years, we have made aggressive efforts to settle older claims, particularly those professional and products liability claims which pre-date our acquisition of Shand/Evanston. The effect of those efforts was a $46 million decrease in our gross loss reserves. In 1993, claim payments totalled $261 million, of which $233 million related to claims from prior years.

In 1993 we offered a number of our reinsurers the opportunity to commute, or pre-pay their liabilities in return for a release from further exposure to changes in reserve estimates. As a result, we collected $66 million in cash from reinsurers who accepted our offer and increased our net loss reserves by the same amount. We will benefit from additional investment income on the cash generated by the commutations, as well as from reduced collection and administrative costs. A potential disadvantage is that we will have less reinsurance protection if our losses develop adversely. We think we have adequately priced for this risk.

Due to the commutations and our success in closing older claims, amounts recoverable from reinsurers were reduced by $119 million in 1993.

## Long-Term Debt

In October 1993 we achieved another milestone. We completed a shelf registration of $100 million in public debt securities, and after receiving ratings from the major independent credit rating agencies, we issued $75 million of 10 year bonds in the public markets.

The bond issue allowed us to repay all of our bank debt and help to reduce our total long-term debt to $78 million at December 1993. At year-end, the ratio of long-term debt to total capital was 34%.

Because interest rates remained very attractive, early in 1994 we sold the balance of the debt under the shelf registration. In total, the debt was issued at an effective fixed cost of 7.5%.

## Shareholder Relations

Although the history of our company dates back to 1930, we are a relatively young public company. Our initial public offering was in December 1986, only seven years ago. As a public company, we have endeavored to treat our fellow shareholders as equal partners.

We are committed to sound business practices and we try to provide complete disclosure so that our partners can fully understand the value of the company. The objective of our shareholder relations program is to attract *and retain* investors who share our long-term goals.

If we are successful in meeting our objective, we would expect our stock to trade at its intrinsic value and be less sensitive to issues unrelated to the value of the company. While we cannot be the most unbiased in determining our own intrinsic value, we believe a significantly undervalued or overvalued stock does not serve our best interests. In 1993, the stock price appreciated 26%, while book value was up 38%.

## Dividends and Splits

We are earning very strong returns on our capital and have confidence in our ability to do so in the future. As a result, we have no plans to institute cash dividends.

The intrinsic value of our company will be the same whether we maintain 5.4 million shares outstanding or split them to increase that number. Splitting the number of outstanding shares will not result in the stock trading at a price more closely related to its intrinsic value. In fact, the opposite may well be true. Of course, we will continue to work to increase the intrinsic value of the company, and we will be happy to see our efforts reflected in the market value of our stock.

## Reported Earnings versus "Real Cash Money"

In managing our business, we try to value sound economic judgment over accounting conventions which often do not represent meaningful economic reality. This philosophy will sometimes result in decisions which reduce accounting earnings, yet increase our "real cash money."

We can find two prime examples of this in our business. First, our investment objective is to maximize total returns. In doing so, we invest in common stocks where we sacrifice current income for the opportunity to enjoy capital appreciation. The value of this policy can be seen in our total returns, which have averaged 11% over the past five years.

A second example relates to the amortization of intangible assets. As a result of prior acquisitions, we have significant amounts of intangible assets. A large portion of these assets are tax deductible and are being expensed on an accelerated basis. While accounting convention requires amortization to be included in operating expenses, the charge bears little relationship to our current cost of operations. Further, due to the accelerated amortization of certain assets, amortization expenses will decrease in the near future. After-tax amortization charges will decline to $.88 per share in 1994 and $.37 per share in 1995.

The following chart emphasizes earnings per share from underwriting and investing activities, which we believe is a more meaningful representation of our operating performance:

| | 1993 | 1992 | 1991 |
|---|---|---|---|
| Core operations | **$3.31** | $3.03 | $2.61 |
| Realized gains | **1.83** | .89 | .94 |
| Underwriting and Investing | **5.14** | 3.92 | 3.55 |
| Gain on sale | — | 2.50 | .28 |
| Relocation expenses | — | (.60) | — |
| Amortization expenses | (.91) | (1.18) | (1.15) |
| Net income | **$4.23** | $4.64 | $2.68 |

Income from underwriting and investing represents the real economic results of our ongoing business operations. Core operations include underwriting and ordinary investment activities. In 1993 and 1992, earnings per share from core operations increased 9% and 16%, respectively.

Realized gains from investments, while inherently volatile and difficult to predict, have also provided significant returns over the past three years. As a percent of our average investment portfolio, returns from realized gains averaged 3% in 1993, compared to 2% in 1992 and 2% in 1991.

Admittedly, we have enjoyed very good financial markets and predicting 1994 and 1995 results would be a dangerous game. Nevertheless, we strongly believe that over the long term, our investment strategy will maximize our returns.

## The Future

We fully expect the insurance industry to be just as competitive in 1994 as it was in 1993. Although we would benefit from an improved market, we aren't counting on it. We believe that we can continue to meet the challenges of a competitive market through our focus on specialty products and niche markets and our commitment to superior quality and excellent customer service. Given our past success, we think we've found a formula that works.

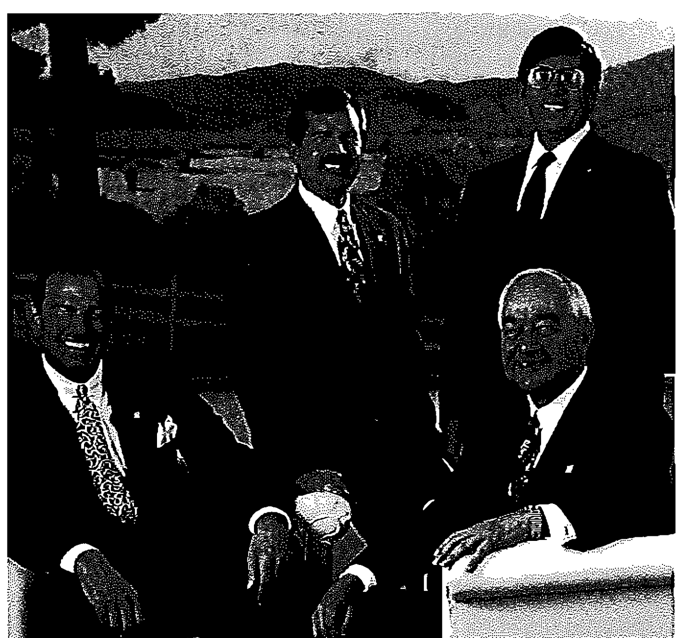
Alan I. Kirshner
*Chairman and C.E.O.*

Anthony F. Markel
*President and C.O.O.*

Steven A. Markel
*Vice Chairman*

Darrell D. Martin
*Executive Vice President and C.F.O.*

*Clockwise from left:* Anthony F. Markel, Darrell D. Martin, Steven A. Markel, Alan I. Kirshner



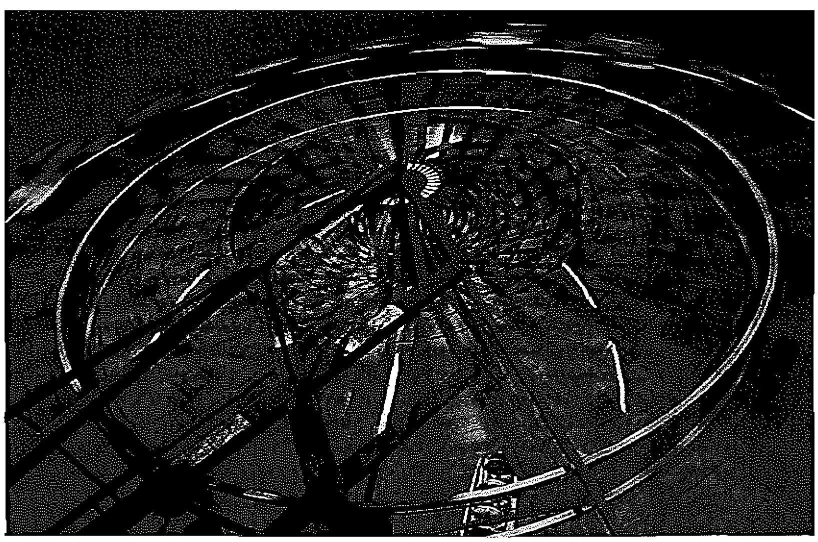
# To our business partners:

It was quite a year. It began with a major earthquake, followed by eleven months of aftershocks from unruly interest rates. Generally, we were very pleased with our results, particularly with our continued underwriting profitability and growing premium base. On the other hand, our investment returns were disappointing, as rising interest rates reduced the current value of our investment portfolio.

The bottom line tells some, but not all, of the story. Net income in 1994 totaled $19 million, or $3.33 per primary share, compared to $24 million, or $4.23 per primary share in 1993. Stockholders' equity at December 31, 1994 was $139 million, or $25.71 per common share, down from $151 million, or $27.83 per common share, at December 31, 1993. Although net income and equity compare unfavorably to the prior year, there is plenty of good news to relate.

**Underwriting performance**

Our underwriting performance was outstanding. Gross premium volume advanced 12 percent over 1993, to $349 million. Higher gross premiums and increasing net retentions propelled earned premiums to $243 million, representing a 26 percent gain over 1993. This increase exceeded our expecta-



Danger is part of the appeal of amusement rides. For Essex Insurance Company, risk is part of the challenge of providing insurance coverage. We devote special attention to track design, maintenance schedules, operator experience and legal liability issues in order to make this type of insurance yield high financial returns.

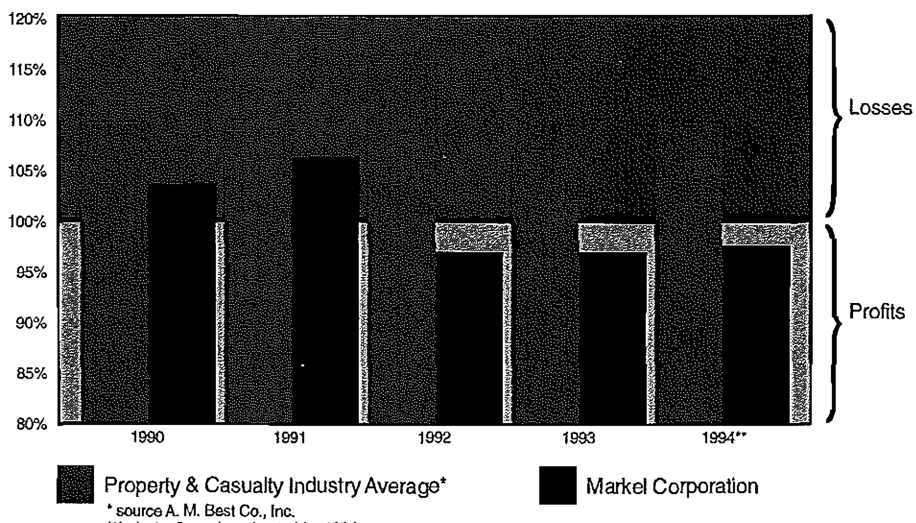
tions, and we are optimistic about continued growth in 1995. Of course, increasing earned premiums doesn't make much sense if the business isn't profitable. So, of all our accomplishments for the year, we are most proud of our continued underwriting profitability. This was the third consecutive year in which we have reported underwriting profits — a record we will work toward extending.

In 1994 losses and expenses amounted to 97 percent of earned premiums, producing an underwriting profit margin of three percent. In 1992 and 1993 we also reported a 97 percent combined loss and expense ratio. While the Northridge earthquake contributed to an increase in 1994's loss ratio to 64 percent from 62 percent in 1993, we improved the expense ratio by holding the line on underwriting expenses. Underwriting expenses as a percentage of earned premiums declined to 33 percent from 35 percent in 1993.

Over the past several years, our growth strategy has been to focus on increasing our own insurance companies' share of the premiums we control. Our net retention of total premiums has increased from 38 percent in 1991 to 74 percent in 1994. Coupled with higher levels of written premiums, these increases have had a significant impact on our earned premium revenue. However, as we reach our target retentions, future

## Underwriting performance

**COMBINED RATIO**




* source A. M. Best Co., Inc.
**Industry figure is estimated for 1994.

The combined ratio measures the underwriting success of an insurance company by comparing the total of losses and expenses to earned premiums. With this ratio, less is more. A combined ratio higher than 100% indicates a loss from underwriting activities; a combined ratio below 100% indicates underwriting profits.

For the last three years, we have reported combined ratios of 97%, producing an underwriting profit margin of 3%. Our results provide a sharp contrast to the losses sustained by the industry over the last five years.

growth must come from an added emphasis on new products, new customers and acquisitions.

We are constantly searching for niche markets and opportunities where we can provide quality products and excellent service with the expectation of earning underwriting profits. In mid-1993 we introduced a special property program that provided commercial property coverage for large property schedules or risks exposed to natural hazards. In 1994 Special Property premiums grew to $21.6 million from $7.5 million in 1993, making it our fastest growing product line. Despite claims from the Northridge earthquake, the program ended the year with highly profitable results.

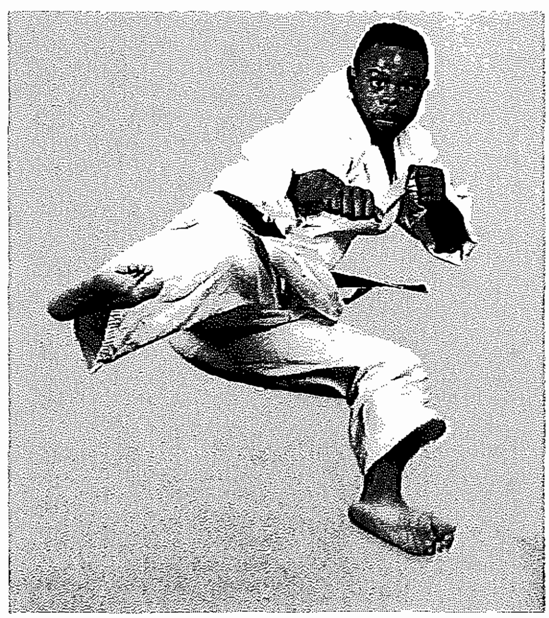
We also added or expanded product lines which we hope will contribute to our future underwriting results. We developed a program for businesses that specialize in local and intermediate distance freight, and extended our animal mortality and farmowners' program into the thoroughbred horse industry. For 1995 we have added a book of business that provides property coverage for mobile homes and low value dwellings. We remain fully committed to our primary goal of underwriting profitability; however, we also expect to find and take advantage of future growth opportunities.

**Investment performance**

Although we enjoyed strong underwriting results, interest rate shocks took their toll on our investment performance. Rising interest rates were both a blessing and a curse. Rate increases finally began to reverse the long decline in current yields, but at the same time caused erosion in the market values of our investments, which reduced realized and unrealized gains over the course of the year. In addition, due to the implementation of a new accounting standard in 1993, stockholders' equity was adversely affected.

Most of our reported investment income comes from interest and dividends and is influenced by the size of the portfolio as well as the yields of individual investments. Our investment portfolio includes tax-exempt bonds that provide slightly lower than average interest income in return for tax advantages, high quality bonds that generate interest at market rates, and common stocks which contribute modest dividend income.

The yield of our investment portfolio tends to track prevailing interest rates. Our net investment income returns have declined since 1990, as a result of the steady decrease in interest rates over the same period. Yields fell from 7 percent of average invested assets in 1990 to 5 percent of average invested assets in 1994. Net investment income has also decreased, from



Would you want to insure schools that teach people how to fight? Markel Insurance Company has been doing it profitably since the early 1980s. We found that martial arts studios' insurance risks could be controlled with certain safety precautions and practices. Both Markel and the martial arts studios benefit from our efforts.

$32 million in 1990 to $29 million in 1994. The decline in income was not as sharp as the decline in yields because our average invested assets grew significantly over the same period.

Reported income also includes realized investment gains. Over the long-term, investment gains are an important part of our reported income. However, it is difficult to predict precisely when gains are likely to be realized. Since 1990, cumulative realized investment gains have amounted to $38 million, but the timing of those gains has been highly variable. To illustrate, although we earned $16 million in investment gains in 1993, rising interest rates limited our 1994 gains to $4 million.

### The total return concept

Reported investment income is important, but our investment strategy focuses on our long-term total investment return. Long-term total return differs from reported results primarily because it includes changes in the market value of our investments, or unrealized gains and losses, and certain adjustments for taxes.

Last year, we commented that realized gains were inherently volatile and difficult to predict. No kidding—and it's doubly true for unrealized gains and losses. Unrealized gains and losses can change by large amounts from one year to the next and introduce significant variability in short-term total returns.

## Investment earnings

| *in millions* | 1990* | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|
| Net investment income | $ 32 | $ 31 | $ 27 | $ 24 | $29 |
| *% Avg. inv. assets* | *7%* | *7%* | *6%* | *5%* | *5%* |
| Net realized gains | 3 | 8 | 7 | 16 | 4 |
| *% Avg. inv. assets* | *1%* | *2%* | *1%* | *3%* | *0%* |
| TOTAL | $ 35 | $ 39 | $ 34 | $ 40 | $ 33 |
| *% Avg. inv. assets* | *8%* | *9%* | *7%* | *8%* | *5%* |
| Average invested assets | $ 433 | $ 462 | $ 463 | $ 503 | $ 605 |

* pro forma

Our investment earnings depend on the size of our portfolio as well as the yields of the investments in the portfolio. Over the past five years, net investment income has declined as lower yields from declining interest rates have offset the benefits of a growing portfolio.

Realized investment gains are unpredictable from one year to the next. Over time, however, these returns are more stable. A portfolio of high quality investments and a long-term outlook can buffer the short-term ups and downs of the financial markets.

Because realized and unrealized returns are volatile, short-term performance measures are not particularly meaningful. An evaluation of total returns over several years is a better test of the effectiveness of an investment strategy. Our tax equivalent total returns over the last five years are strong. The five year weighted average return of our portfolio was 7.9 percent. Bonds earned 7.8 percent, and equities were even higher at 11.0 percent. We're proud of these results, and we will work to do even better in the future.

### Investment results & the balance sheet

In December 1993 we adopted a new accounting standard that required our bond portfolio to be carried on our balance sheet at its market value. Previously our bond portfolio was shown at amortized cost. Under this new standard, changes in the market value of the bond portfolio are reflected in stockholders' equity as unrealized gains or losses. When we implemented the standard in December 1993, our bonds and equity investments had unrealized after-tax gains of $22 million, and we adjusted stockholders' equity accordingly. In 1994 increased interest rates caused the market value of our portfolio to decline significantly. As of December 31, 1994 our investment portfolio had unrealized after-tax losses of $6 million, a change of approximately $28 million, or $5.31 per common share.

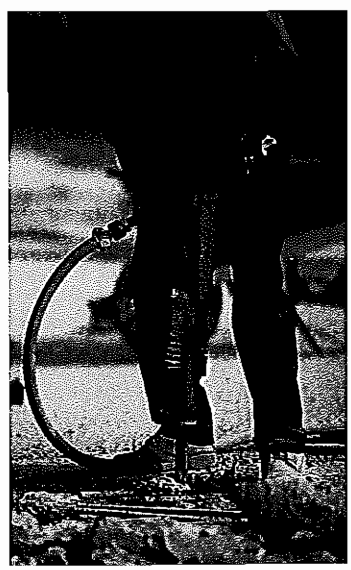
### Investment outlook

The good news about investments is that we can expect higher yields in 1995 due to the interest rate increases of 1994. The unrealized losses associated with our bond portfolio will decline as bonds mature at par value and the proceeds are reinvested at higher rates. Also, we will benefit from continued growth in our investment portfolio, which increased to $612 million at December 31, 1994 from $360 million at December 31, 1990.

Although our equity returns in 1994 were less than we hoped, we are optimistic with respect to the future. We remain convinced that our long-term, value-oriented approach to equity investments will result in enhanced returns to our shareholders.

### Runoff issues

Since the acquisition of our Shand/Evanston subsidiary in 1987, we have been trying to conclude several of the underwriting programs and reinsurance contracts which pre-date our ownership. In 1994 we



One-Call systems help construction crews locate underground pipes and cables. But if a One-Call system provides information that results in damage, that system may be held liable. Some insurance companies don't have the expertise to develop small markets like One-Call systems. The Evanston Insurance Company prides itself on underwriting for unique risks and specialized professions.

made significant progress in resolving many of the issues surrounding the runoff of these programs and contracts.

Perhaps our most important accomplishment was the reduction of our exposure to environmental impairment liability (EIL) and pollution and pollution-related bodily injury (toxic-tort) claims. These types of claims are among the most unpredictable the property & casualty industry has confronted. Unlike many companies which have adopted a "wait and see" attitude to the complex legal, economic and social issues surrounding these exposures, we have worked hard to set reserves realistically and to close claims as aggressively as reasonably possible. In 1994 we reduced our EIL exposures to 11 active sites from 109 active sites in 1993. More important, the uncertainty with respect to our remaining exposures has also diminished. Our open toxic tort claims, which tend to be less severe than EIL claims, also declined significantly to 307 from 417.

We continued our program of offering certain Shand/ Evanston reinsurers the opportunity to commute, or prepay, their liabilities in return for a release from further exposure to changes in reserve estimates. While our net loss reserves increase because of the commutations, we benefit from the cash they generate and lower

## Total investment returns

**ANNUAL TAXABLE EQUIVALENT TOTAL RETURNS**

| *(In percent)* | 1990* | 1991 | 1992 | 1993 | 1994 | 5 yr. weighted avg. ann. return |
|---|---|---|---|---|---|---|
| Equities | (7.0) | 26.9 | 13.1 | 28.7 | (3.3) | 11.0 |
| Fixed maturities | 10.3 | 15.1 | 7.8 | 9.1 | (0.2) | 7.8 |
| Total portfolio | 6.2 | 17.0 | 8.2 | 11.8 | (1.1) | 7.9 |

* pro forma

We emphasize long-term performance measures because realized and unrealized investment returns are volatile. A good test of our investment strategy is an evaluation of total returns over several years. Although returns in 1994 did not meet our expectations, our taxable equivalent total returns over the last five years continue to be strong.

collection and administrative costs. Of course, there is always the risk that we will have less reinsurance protection if reserves develop beyond our estimates, but we believe we have adequately provided for this risk. Balances for unpaid losses due from reinsurers declined to $181 million at December 31, 1994 from $261 million at year-end 1993 and $380 million at year-end 1992.

Finally, we were successful in reaching an agreement with Shand/Evanston's former owners concerning indemnification agreements related to our purchase of Shand/Evanston. These matters have occupied a great deal of our time and energy over the past four years. Now, with the uncertainty of these issues significantly reduced, we can focus our full attention where it belongs — on the future.

### Passages

Markel's growth and strategic evolution from a small family-owned brokerage firm to a publicly-held underwriting operation has been a gratifying adventure for all of us who have taken part in it. On a sad note, we report the death of one of our leaders in that adventure, Stanley B. Markel. Stanley retired from "active duty" after more than 50 years of service, including 29 years as our President and Vice Chairman. We can attribute a large measure of our success to the corporate

## Overall performance

**EARNINGS PER PRIMARY SHARE**

| | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|
| Core operations | $ 1.95 | $ 2.61 | $ 3.03 | $ 3.31 | $ 3.77 |
| Realized gains | (0.06) | 0.94 | 0.89 | 1.83 | 0.45 |
| Non recurring | (0.41) | 0.28 | 1.90 | — | — |
| Amortization expense | (0.43) | (1.15) | (1.18) | (0.91) | (0.89) |
| NET INCOME | $ 1.05 | $ 2.68 | $ 4.64 | $ 4.23 | $ 3.33 |

We believe the earnings power of our business is best reflected in the results of our core underwriting and investment operations. Core operating results exclude realized gains, which can be volatile, and expense related to the amortization of intangible assets, which does not stem from our current activities. We also exclude income and expenses related to one-time events, such as the sale of product lines or business units.

Underwriting profitability, increasing premiums and a growing investment portfolio have all contributed to an 18 percent average growth rate in core operating earnings since 1990.

mission and values that Stanley helped establish — the mission and values that are today expressed in the *Markel Style.* Stanley's intelligence, wit and disdain for bureaucracy will be remembered by all of us who knew and worked with him, and his commitment to success will always be the cornerstone of Markel Corporation.

**In conclusion**

We expect the landscape of the property & casualty insurance market to change, either by man or by nature, and we're ready to meet the challenges of that change.

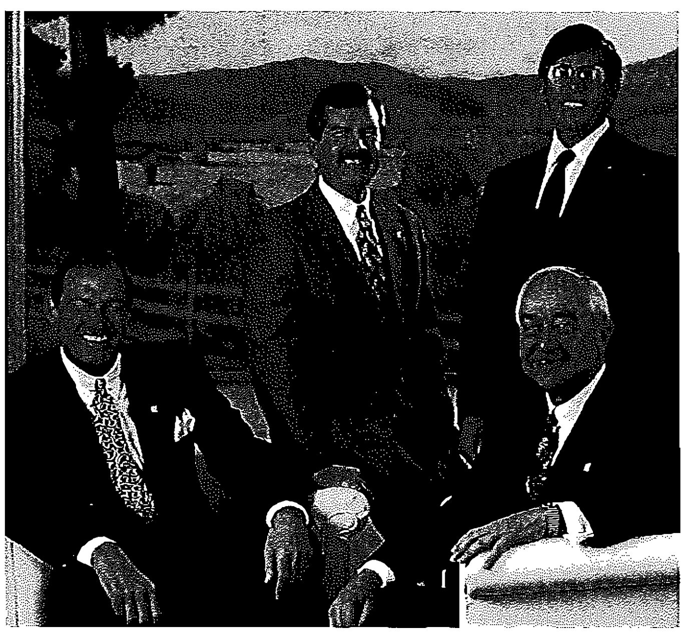
The risks of our business will never be completely avoidable, but they are manageable. We manage the insurance and financial risks of our business with a commitment to consistent underwriting profits and superior investment returns. Our success in accomplishing those objectives is due in large part to the principles that guide us and form the *Markel Style*. We really do believe in the ethics outlined in our *Style* — hard work and a zealous pursuit of excellence, market leadership through quality products and services, and constant improvement. We believe it because time and time again, we've seen it work.

Alan I. Kirshner
Chairman & C.E.O.

Steven A. Markel
Vice Chairman

Anthony F. Markel
President & C.O.O.

Darrell D. Martin
Executive Vice President & C.F.O.



Clockwise from left:
Tony Markel, Darrell Martin,
Steve Markel, and Alan Kirshner

# To our business partners

During 1995, we enjoyed success in almost every aspect of our business. Insurance operations continued a record of underwriting profitability; investment returns were exceptional; and net income of $34.5 million or $6.15 per share reached a record level. Shareholders' equity per share grew to $39.37—an increase of 53%.

The real success, however, is not just in our 1995 achievements, but in our long-term performance. Our 1995 accomplishments were produced by the hard work and commitment of our associates over many years. Together, we have built a foundation that has yielded outstanding results this past year, but more importantly, will prompt achievement well into the future.

## An Industry with Opportunity

The property/casualty insurance industry seems to be permanently stuck in an intensely competitive cycle. Most companies in the industry sell commodity products, competing by offering the lowest price. Poor industry-wide results from this strategy and expensive environmental liabilities from the past have resulted in sub-standard shareholder returns. This has created a wave of reorganization and consolidation in the industry.

During the past few years several major property/casualty companies have fallen victim to this reorganization. Home Insurance Company's business was taken over by Zurich; Continental sold out to CNA; Aetna announced a deal with Travellers; and Talegen (formerly Crum and Forster) is being acquired by KKR. CIGNA has separated its good business from its bad business. In 1994, the Home, Continental, Aetna, Talegen and CIGNA wrote $14 billion, which represented almost 6% of the industry's total premiums.

With change—especially change of this magnitude—there will be opportunities. We hope to be smart enough to take advantage of them, although we can't necessarily predict how we will respond.

## Our Strategy

Markel Corporation is focused on specialty products in unique market niches. "Specialty," "unique" and "niche markets" are words and phrases that have often been mis-used and certainly over-used in our industry. For us, however, they define our commitment to know our customers' needs and to provide them with quality products and services. In doing so, we expect to earn underwriting profits.

Underwriting profits are a key component of our strategy because they prove our knowledge and expertise, our commitment to superior customer service, and our ability to manage insurance risk.

## Underwriting Results

In 1995, we again operated with an underwriting profit, recording a combined loss and expense ratio of 99%. For each of the three preceding years, our combined ratio has been 97%. As indicated by these ratios, in 1995 we experienced a slight narrowing of our profit margin. This decline was caused by disappointing results with a few programs and the reduction of high profit margins in some other lines of business. While we recognize the increased combined ratio, we remain pleased with our underwriting results.

**Alan I. Kirshner**
*Chairman and Chief Executive Officer*
*As the owner of over 100 fine horses, Alan Kirshner leads Markel to the equine insurance marketplace. As Chairman, he guides us to a market leadership position in the niche markets we serve. We're not saying running a successful corporation is like breeding or selecting horses, but we do think passion is essential. Alan's passion for people and excellence is the key to Markel's success, and to the inspiration and leadership he brings to our team.*

We maintain our long-standing policy of establishing loss reserves conservatively, with the hope that ultimately, our reserves will more likely be redundant than deficient. We believe our reserves today are as strong as ever.

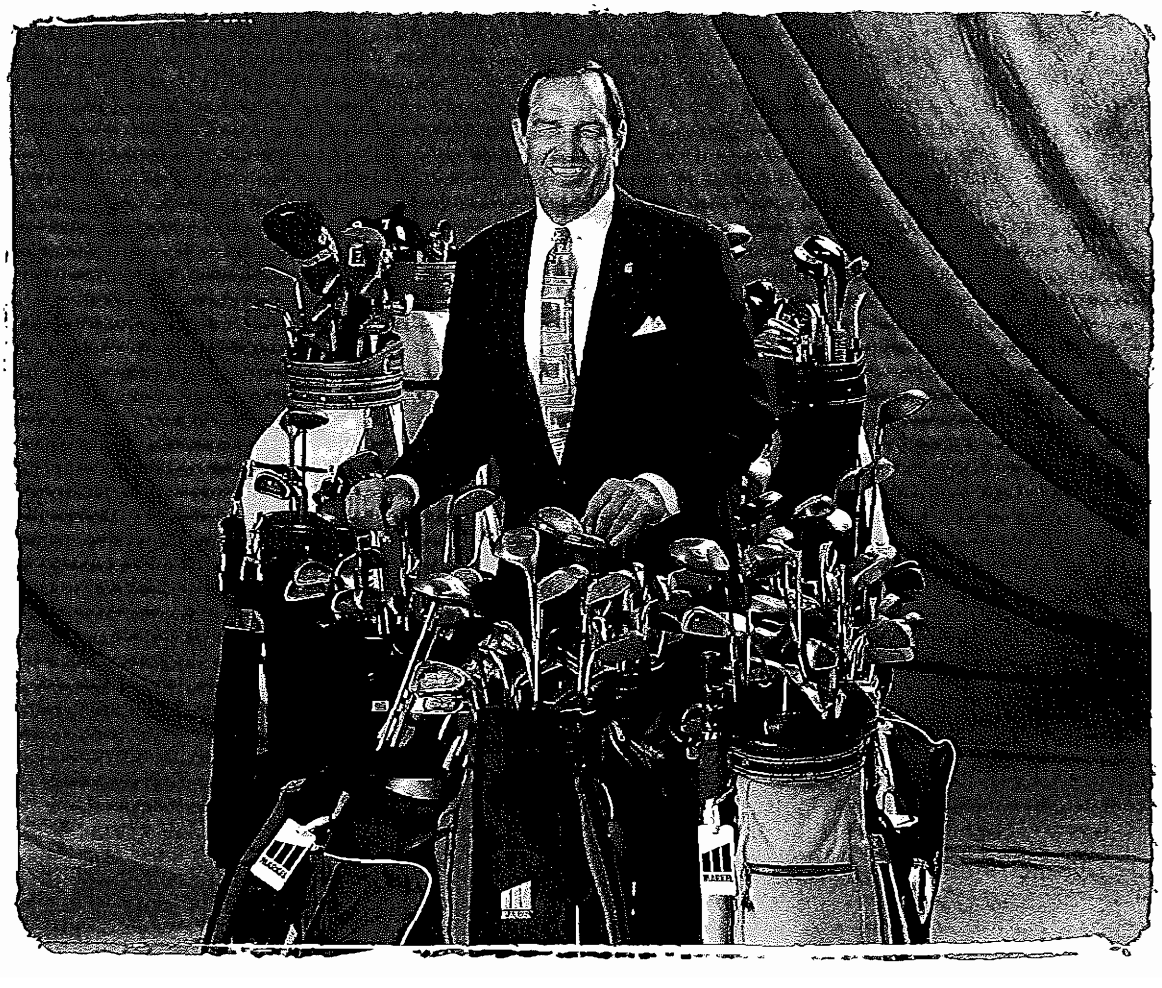
**PREMIUM GROWTH**

In 1995, gross premium volume increased 15% to $402 million from $349 million in 1994. The $53 million increase in 1995 was fueled primarily by premiums from our newer products: several auto programs started in late 1994 that contributed $13 million to the growth in premiums, $13 million in production from a personal property program focused on low-value dwellings, and $13 million in additional premiums from a special property program initiated in 1993. Business acquired as a result of the acquisition of Lincoln Insurance Company also added $7 million to gross volume.

Earned premiums rose 17% to $285 million from $243 million in the preceding year. Over the past five years, the compound annual growth rate in

**Anthony F. Markel**
*President and*
*Chief Operating Officer*

*An avid golfer, Tony Markel knows the players, the game and the courses. These are nice skills to have when you're President and Chief Operating Officer, and are considering what's doable, who should do it and how it should be done. Tony knows underwriting profitability as well as he knows golf, and he loves it just as much. As shrewd as he is hopeful, Tony refrains from playing in a tournament if we're underwriting the Hole-in-One coverage.*



earned premiums averaged 54%. Increased retention of premiums and higher premium volume have pushed earned premiums from $152 million in 1991 to $285 million in 1995. While profitable growth in the current competitive environment may be difficult, it is certainly not impossible. Our best guess is that our overall growth in the future will be slower than in the past. We expect modest growth from most of our existing products, supplemented by stronger growth from our newer lines. We will also look for chances to develop or acquire new products.

**INVESTMENTS**

Our corporate philosophy clearly recognizes the importance of both underwriting profits and superior investment returns to build shareholder value. A strong loss reserve position and solid underwriting track record give us the financial strength and flexibility to manage our investment activity for higher returns. The growth in income and book value achieved in 1995 is largely due to exceptional investment results.

During 1995, the portfolio grew 49% to $909 million. This growth occurred because of several factors. Most important was the internal growth due to operating cash flow. Our business continues to generate cash at a rate that is faster than is required to meet our claim payments. In addition, strong financial markets in 1995 increased the market value of our investments by $62 million.

There were some one-time transactions that also contributed to the large increase in invested assets in 1995. These include $83 million generated by commutations with reinsurers, $60 million related to the acquisition of Lincoln Insurance Company and $19 million from the sale of our home office buildings, which we will continue to occupy under the terms of a long-term lease.

Income from dividends and interest in 1995 totaled $43 million compared to $29 million in 1994. The increase in the size of the portfolio was the primary reason for the rise in investment income, although the annualized yield also improved in 1995.

In 1995, we realized $12 million in capital gains, up from $4 million in 1994. Approximately 40% of our capital gains were generated from our fixed income portfolio, as we sold investments to reduce our exposure to municipal bonds. The equity portfolio produced over $7 million of realized capital gains. We are focused on long-term, total returns from our equity investments and cannot predict the timing of equity gains. Our strategy is to invest in companies with the potential for appreciation and hold these investments over the long-term. With this approach, we can enjoy the increases in unrealized gains and the (often significant) benefits of deferring the capital gains tax.

The improved security markets, and hopefully some smart selections on our part, resulted in a net unrealized gain of $34 million at December 31, 1995. This is after allowing for (but not paying) $18 million in deferred capital gains taxes.

Our overall investment results in 1995 were superior. Total returns were 29.7% in equities, 14.4% in fixed maturity securities and 15.7% for the entire portfolio. Over the past five years, total returns were 19.2% in equities, 9.5% in fixed maturity securities and 10.3% overall. These five-year total returns include almost $47 million in capital gains, much of which came from our equity investments.

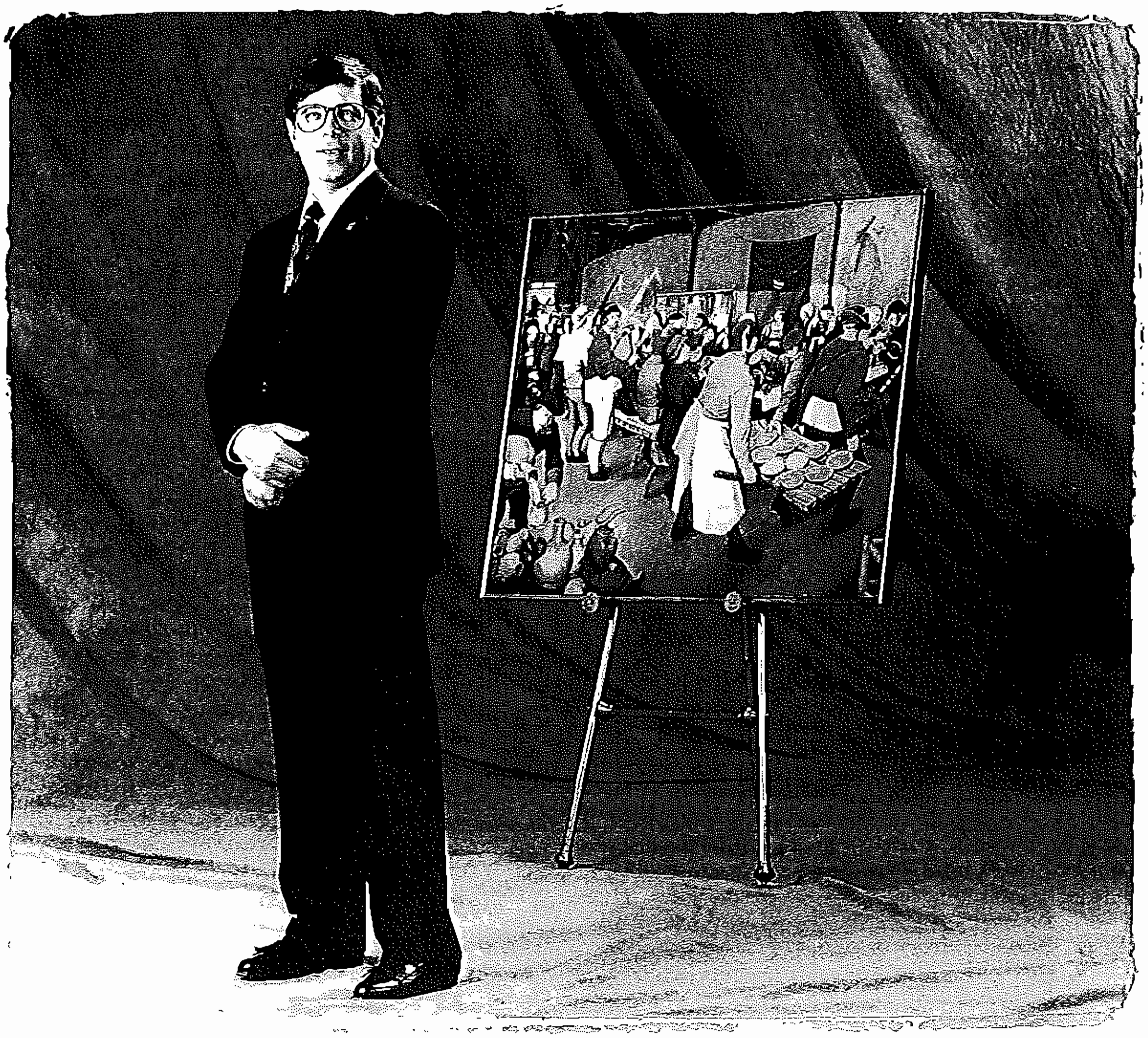
### Reasons for Success

As we have said, we are gratified with this year's performance, but more importantly, with our long-term achievements. We believe the primary reason for these results has been the commitment to success made by our associates. This year, we are pleased to focus our report on that group of people — the chief architects of our success.

Over the years, we have established several programs which try to ensure that our customers' interests, our associates' interests and our shareholders' interests are all aligned, and that each group is focused on the same objectives. These programs involve both cash incentives and stock ownership opportunities.

### Bonus Plan

In managing our total compensation program, we want salary and benefits to be competitive with the marketplace, but not exceptional. On the other hand, we do seek to establish exceptional bonus and stock ownership opportunities, so that we can attract and reward those individuals who make extraordinary contributions to our organization.



**Steven A. Markel**
*Vice Chairman*

*How can you capture the essence of a Renaissance man in a few sentences? Steve Markel is one of those people whose nimble intellect and creative spirit give him the ability to develop and weigh investment strategies, to consider the form and function of fine art, and to evaluate the risks of insuring pizza delivery drivers — often within the same half hour. He'd make a terrific underwriter for our special risks insurance programs if he weren't so busy being our Leonardo and Vice Chairman.*

Our bonus plan has three levels of participation. First, all associates have the opportunity to earn a meaningful cash bonus if they meet the high performance standards and individual goals outlined in their bonus agreements. Second, those associates who have a direct impact on underwriting results can earn bonuses explicitly related to the underwriting profits generated by their product or division. Finally, senior executives are rewarded based on the five-year compound annual growth in book value per share. Our goal is to grow book value by 20% per year; no bonus is paid to senior executives unless we exceed a minimum threshold of 15% compound annual growth over a five-year period.

### Stock Ownership Opportunities

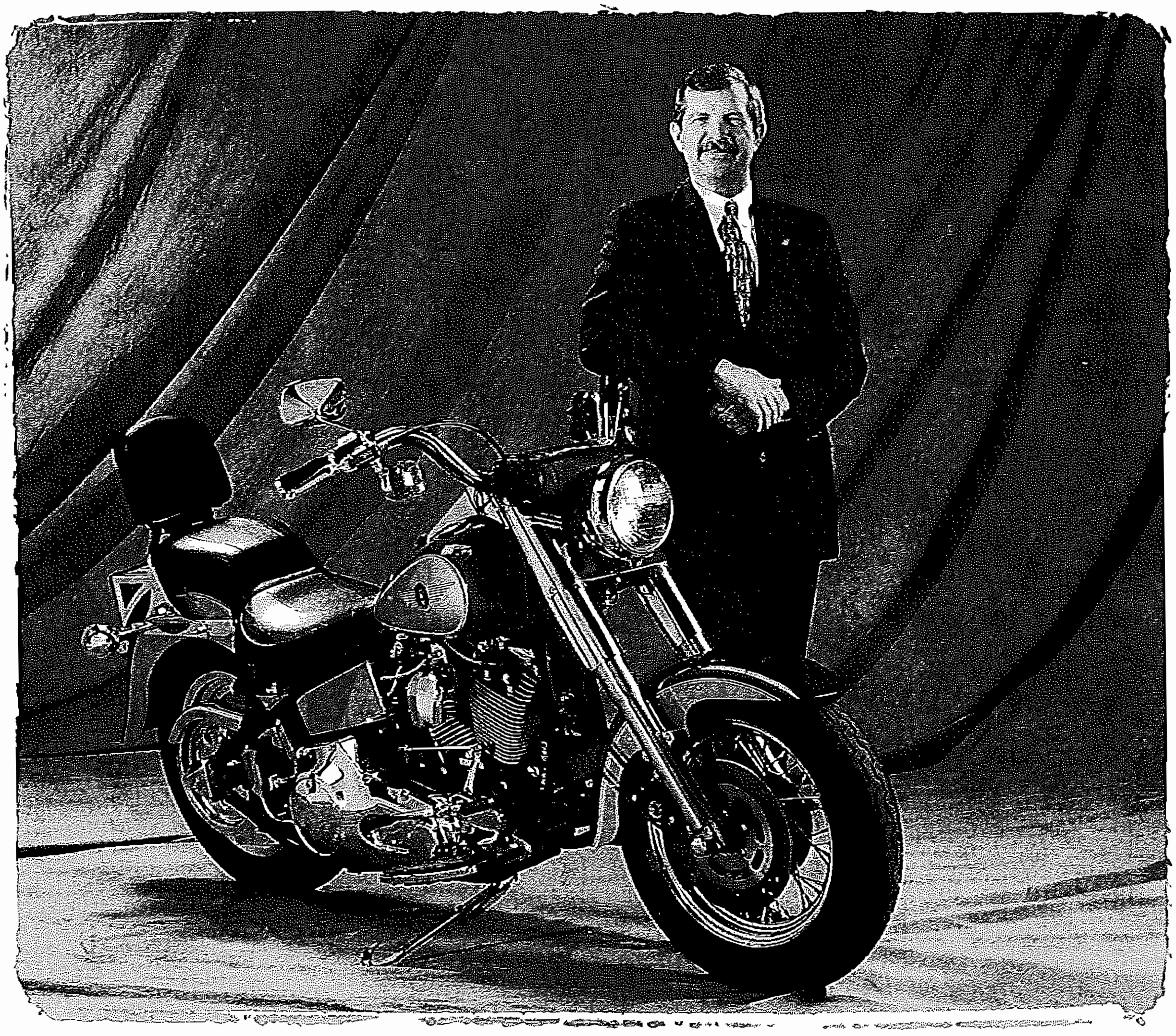
While cash compensation incentives are effective in aligning our associates' interests with our shareholders', we believe that direct stock ownership can be even more powerful. One of our main objectives when we became a public company in 1986 was to achieve broad stock ownership among our employees. At the time, our bonus program did not exist, so we generously distributed stock options as incentive compensation as well as an inducement to stock ownership.

Stock options may encourage future stock ownership, but we believe that a "gift" of stock options is not as effective in generating a long-term commitment to the Company as an actual purchase of stock. The act of making a personal investment in our Company is a critical step in encouraging an associate to begin to think and act like an owner of the business. Therefore, we do not expect that additional stock options will be a significant part of our incentive compensation plans in the future.

We offer many opportunities for associates to become shareholders. Every employee who is eligible for participation in our retirement program [a 401(k) plan] receives Markel stock—purchased

**Darrell D. Martin**
*Executive Vice President and Chief Financial Officer*

*As savvy enthusiasts (and smart insurance companies) know, the right driver can make motorcycling a safe and satisfying pastime. The ideal operator combines experience with a healthy respect for the opportunities of the machine and the risks of the sport. That profile also fits Darrell Martin, Executive Vice President and Chief Financial Officer. For eight years, he's been successfully navigating the Company through the opportunities and risks of an ever-changing business environment. And we sure do appreciate his good driving record.*



in the open market—as part of the Company's contribution to the plan. In addition, associates can designate all or part of their contribution for investment in the Company's stock. At December 31, 1995, the 401(k) Plan owned over 113,000 shares.

Associates may also acquire our stock through a payroll deduction purchase plan. They can set the amount to be deducted from each paycheck, and accumulate as much stock as their individual financial situations will allow. The Company supports the program by covering the administrative costs and commissions, and also by awarding an additional share for every ten shares purchased through the plan.

Most recently, we offered all associates an opportunity to purchase stock with low interest financing which was partially subsidized by the Company. Over 200 associates participated in this program. At December 31, 1995, over 125,000 shares were owned by these stock purchase plans.

In the aggregate, we estimate associates' ownership at about 32.5% of the Company. This provides a powerful incentive for all of us to focus on our long-term success. As shareholders, we all share the results of our performance.

### SAYING GOOD-BYE

For the second year in a row, we mark the passing of one of the members of the Markel team who guided the Company from its early days. Milton Markel was one of two sets of twin boys who were the sons of Samuel Markel, our founder. Milton was a businessman whose common sense and integrity served as an inspiration for a generation of Markel leaders. We will miss his optimism and his dedication.

### SAYING THANK YOU

As a public company, we have been fortunate to have equity partners who have believed and invested in us. You have given us a vote of confidence that we recognize and appreciate. In return for this trust, we have and will communicate openly and honestly with you, and embrace the challenge of building the value of our Company over the long term. Our past success has been achieved together. We hope that together, we can look forward to a prosperous future.

Alan I. Kirshner

Alan I. Kirshner
*Chairman and Chief Executive Officer*

Anthony F. Markel

Anthony F. Markel
*President and Chief Operating Officer*

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Steven A. Markel
*Vice Chairman*

Darrell D. Martin

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*Executive Vice President and Chief Financial Officer*

## To Our Business Partners

We finished 1996 pleased with our achievements and long term success, yet challenged and committed to do even better in the future. Despite problems in a few products and storm losses from Hurricane Fran, we were able to achieve our primary objective of earning an underwriting profit. We closed 1996 with a combined ratio of slightly less than 100%, achieving our goal by a small margin. The extraordinary underwriting success of Essex Insurance Company saved the day.

Despite our modest underwriting profit, 1996 proved quite successful financially. For the year, total operating revenues grew 7% to $366.7 million; core underwriting and investing results were $33.9 million, up 17% from the prior year; and net income was $46.7 million, or $8.30 per share, a Company record. Additionally, we enjoyed a significant increase in the value of our investment portfolio. Together, these items resulted in an increase in shareholders' equity per share of 25% to $49.16.

In the ten years that we've been a public company, we've enjoyed consistent success in almost every financial measure. Revenues have increased at a 31% compound annual growth rate; we have earned underwriting profits in nine out of the ten years; our investment portfolio has grown at a 44% compound rate and now totals $1.1 billion or $207 per share; and most importantly, book value has risen to $49.16 per share, a compound annual increase of 31% over the past 10 years.

We attribute this success to a number of factors. Maybe the most important factor is a strong corporate culture which has enabled us to build a team focused on a common goal, building long-term shareholder value. Very much a part of this culture is the common sense business principle of operating and decision-making using what Ben Graham described as a margin of safety.

Ben Graham is widely recognized as the founding father of modern security analysis. He developed and taught an investment decision-making framework based on sound business principles. His primary investment concept was to operate with a margin of safety.

Graham's margin of safety, simply stated, is the attempt to build a safety net into investment and business decisions. The margin provides a cushion against errors and unfavorable results. This margin is achieved by acting on facts rather than emotions, conservatively forecasting outcomes, diversifying risk and erring on the side of safety when presented with options. Consistently applied, the concept is a powerful business tool. At Markel we attempt to apply Graham's concept to all our decisions.

Regardless of whether we are dealing with accounting philosophy, loss reserving, underwriting, or investing, we seek to operate with a margin of safety.

## Accounting Philosophy

At Markel we believe in conservatively stating our financial picture. Financial strength is an important component of our success. Our insurance clients are entitled to the greatest security we can offer, and our shareholders seek to increase the value of their investment. We believe the best way of achieving both of these goals is by building book value per share.

In the insurance business, earnings per share is not the best measure of financial performance. It is more important to establish adequate loss reserves and maintain a strong financial position. We value a strong balance sheet more than current earnings in any single year. Management is rewarded, as are shareholders, by building book value on a per share basis over long periods of time.

Because we believe in the importance of conservative accounting, we often make choices which make economic sense but do not always enhance current earnings. For example, in 1990 we negotiated as part of the purchase price of Shand/Evanston a non-compete agreement that was amortized over four years rather than 40 years as goodwill. While this resulted in an annual charge against earnings of approximately $5.0 million rather than $0.5 million, it was beneficial in at least two ways. We received significant tax benefits, and we built a stronger and more conservative balance sheet due to the accelerated amortization.

Another recent example of this philosophy is the $18.4 million tax benefit recognized in the second quarter of this year. Over the past several years, we conservatively established our financial statement tax reserves. We determined that our estimated tax liabilities were actually less than previously accrued and adjusted the tax liability accordingly.

Most recently, in order to reduce future expenses, we made the decision to sell our office building in Evanston, Illinois. This property was acquired as part of our purchase of Shand/Evanston. Over the years, the commercial office market in Evanston has declined. Because the expected proceeds will be significantly less than the carrying value of the building, we immediately recorded the after tax loss of $6.8 million in 1996.

## Loss Reserving

Because it is the largest and most difficult to measure, the provision for unpaid losses and loss adjustment expenses is the most important account on an insurance company's financial statement. This is certainly the case for Markel. This account also best represents our philosophy of conservative accounting and providing a margin of safety. As we have said many times, our goal is to establish loss reserves at a level that is more likely to prove redundant than deficient. This standard of setting loss reserves is somewhat different from other insurers.

A.M. Best Co. recently estimated that the Property and Casualty industry is under-reserved by $82.8 billion, or 23% of total reserves. We believe that much of this shortfall is related to companies' desire to report earnings.

This illustrates why we do not stress current earnings. At Markel we seek to establish loss reserves at a level that anticipates the inevitable surprises that can and do occur and to provide for an appropriate margin of safety.

We constantly review our businesses and try to make sure the reserves we provide are adequate to meet future exposures. Getting the loss reserves right is critical to being able to make an underwriting profit. Current loss estimates not only affect financial results but also influence many pricing and risk selection decisions. Each year we try to make sure our margin of safety is as strong as it was in the prior year.

In the insurance business, we sell the product before we know the actual cost. Claims often take many months or years before they are fully reported and settled. Obviously, as the underwriting years mature, we are better able to estimate the ultimate cost. Consequently, we regularly adjust loss reserves as more information is available.

The best way to understand and analyze this process is to review the loss reserve development schedule shown in Management's Discussion and Analysis on page 55 of this report. From this schedule you can see that we have consistently benefited from redundant loss reserves. For example, in December of 1991 we had loss reserve provisions of $557.6 million. This estimate was reduced in each of the following years as we became more confident that the actual results were better than originally provided. However, in each year we have attempted to maintain a margin of safety. Five years later we've recognized $56.5 million or 10% of the beginning estimate in redundancy. Looking at 1995 loss reserves you will see the same trend. During 1996 we realized approximately $24.1 million in redundancy from the prior year. This represents 4% of the original reserve amount. We continue to believe that the remaining reserves have a margin of safety and hope to see continuing positive development.

The very nature of the insurance business makes it difficult to establish loss reserves with certainty. In fact it cannot be done. But what we can do is make provisions with a view that to the extent we're wrong, we have erred on the side of safety.

It is unfortunate that in the world of financial reporting and security analysis that current earnings receive more attention than the quality of loss reserves. That does not make it right. We would much prefer to be pessimistic when setting loss reserves than optimistic about current earnings. This philosophy benefits every aspect of our business. It supports our underwriting profit orientation; it supports our investment activity; and it helps build our margin of safety.

## Underwriting

Earned premiums in 1996 amounted to approximately $307.5 million, spread over more than 40 different product lines in our five operating divisions. In the past five years, we have enjoyed modest underwriting profits, reporting a combined ratio from 97% to slightly under 100%. Because this ratio has been relatively consistent, one might assume that each of our product lines produces predictably consistent results. This is not the case. Our aggregate combined ratio is a result of many profitable lines of business balanced against some which are having difficulty. Each product line has unique characteristics and different profit objectives.

New products often experience a higher than desired combined ratio because the costs associated with new product development are higher than after the product is fully established. Occasionally, expectations are not met and products simply develop more losses than we plan. Some products are exposed to weather events, and the results will vary accordingly. Fortunately, most of our businesses do in fact generate underwriting profits so that we enjoy a sufficient margin of safety to cover underwriting losses which inevitably occur.

During the past few years, our specialty personal and commercial lines unit entered the mobile home insurance business. Over time, we expect this product to earn underwriting profits of 10% or more to achieve our return on equity goals. The business does not generate large amounts of investment income since claims are paid quickly. Additionally, the results from this line of business can be volatile because the insured structures are exposed to wind and hail losses. Unfortunately, 1996 was a bad year for this business as we absorbed approximately $1.7 million in losses from Hurricane Fran. While the impact was modest to Markel, this product line suffered an underwriting loss in 1996. In spite of these problems, we still expect to see combined ratios in the low 90's over time.

Within the same unit, we also provide insurance for motorcycles and personal watercraft. These products have enjoyed steady growth and consistent underwriting profits over the past several years, and we expect they will continue to make a nice contribution to our results in the future.

In 1996 we also experienced underwriting losses in our physicians' medical malpractice area. One problem involved a program providing insurance for a large group of emergency room physicians. This particular program did not provide enough rate for the exposure. Unfortunately, we were unable to correct the problem, so we exited the line of business. In another segment, we found certain classes and territories which needed rate adjustments, and we acted accordingly. We are now comfortable with this business.

The same division also has a variety of programs for other medical professions. These include coverage for exposures such as ambulance services, dialysis clinics, home health care agencies and outpatient centers. Also included is coverage for medical and allied health professionals, such as emergency medical technicians, x-ray technicians, paramedics and social workers. These segments of our medical malpractice business have proven to be consistently profitable over a number of years, and 1996 was no exception.

In late 1993 we began a new property program, Markel Special Property, which provides large commercial coverage with some catastrophe exposure. Fortunately, the Northridge Earthquake in January 1994 occurred before we had written much business. While this event hurt our 1994 results, it actually was positive for us as it expanded our market opportunity as competitors exited the market. The lack of major catastrophes since then has contributed to our success. In 1996 we earned substantial underwriting profits in this line of business on increasing premium volume.

Our most consistently profitable product line has been our small, commercial general liability business written on an excess and surplus lines basis by Essex Insurance Company. This product line includes a very broad list of categories including contractors, bars and taverns, offices and habitational risks, manufacturing and small products coverage. In this area we excel in providing customer service due to our expertise and responsiveness. As with most of our businesses, our success is the result of the efforts of a group of highly talented, seasoned insurance professionals.

## Investing

We believe it is important to manage our investment operation with the same thought, diligence and margin of safety as our underwriting operations. Excellent investment results combine with our underwriting profits to produce superior long-term growth in book value. Our investing philosophy is based on the goal of achieving the best after tax total return and protecting the integrity of our insurance operations. We focus on total return rather than current income. We seek to build value.

We allocate our investment dollars by segregating our portfolio based on the source of the funds. Funds provided by our policyholders are invested in high quality, short duration, fixed income securities to assure the funds will be available to meet claims liabilities. Funds provided by shareholders are generally invested in common stocks of companies we believe will grow and build long-term value. We try to buy these companies at prices at or below our estimate of their intrinsic value. This method of allocation and investment approach helps build a margin of safety.

Our fixed income portfolio is managed to minimize interest rate and credit risk. We therefore have a short duration and high quality portfolio. To maximize after tax total returns we own tax-exempt municipal securities. We also purchase bonds with unique "put" features to provide additional returns if interest rates fall.

In our equity portfolio, we try to avoid undue risk of loss by knowing as much as possible about the companies we purchase. We do extensive research on the companies, and we visit and talk with their managements. Because of our knowledge and comfort with the insurance industry, we often buy other insurance stocks. We are long-term holders.

We like the idea of building large unrealized capital gains. To the extent that gains are not realized and taxes are deferred, we can continue to invest money that would have been used to pay taxes. At December 31, 1996, our unrealized gain on equity securities amounted to $60.8 million. For accounting purposes, taxes of $21.3 million have been provided on this unrealized gain. Among its other virtues, this also creates a margin of safety. When future markets cause lower stock prices than today, the book value impact will be cushioned by this tax provision.

While we expect to continue to benefit from our investment flexibility, we are extremely aware that our ability to do so is dependent upon continuing to conservatively provide for our loss reserves and earning underwriting profits.

## Other Events

In October 1996 we completed the acquisition of Investors Insurance Holding Corp. While this company has had a difficult history, the former owners brought in a new management team and began to develop a sound business plan in 1995. We liked what we saw and had an opportunity to buy the company at an attractive price. This acquisition enables us to expand our product offerings in the excess and surplus lines market.

In January 1997 we saw the opportunity to raise $150 million on terms that we felt were very attractive. Somehow it is always easier to raise capital when you don't need it. Believing that we would find a sound use for the funds in the not too distant future, we took advantage of the opportunity. The security we sold to raise the capital was a trust preferred stock at a cost of 8.71%. The security matures in 49 years, although we can redeem it in ten years. One unique feature of this security is that we can defer interest payments for five years. As a result of the long maturity, the interest deferral and the subordination provisions, this security has many of the benefits of equity, yet its cost is like debt. In the short run, we will lose money as a result of this financing because the proceeds have been invested in short-term securities earning less than the 8.71% cost. Obviously, in the long run we think this financing will benefit our total capital structure.

## A Look to the Future

Every year we spend a lot of energy with each of our businesses reviewing the past and planning for the future. At the corporate level we also analyze our results and try to figure out how to best take advantage of the opportunities we face. We approach 1997 with a good plan and expect to achieve continued success. In spite of our plan, we will face both problems and opportunities that we have not anticipated. The insurance industry continues its evolution and reorganization. Markel is stronger and better prepared than ever before. We face our future with great optimism.

Thank you for your loyal support and encouragement.

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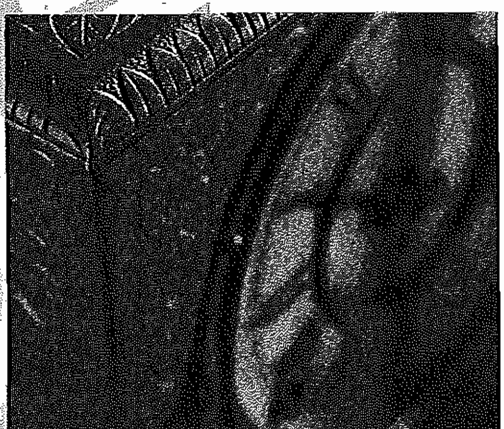
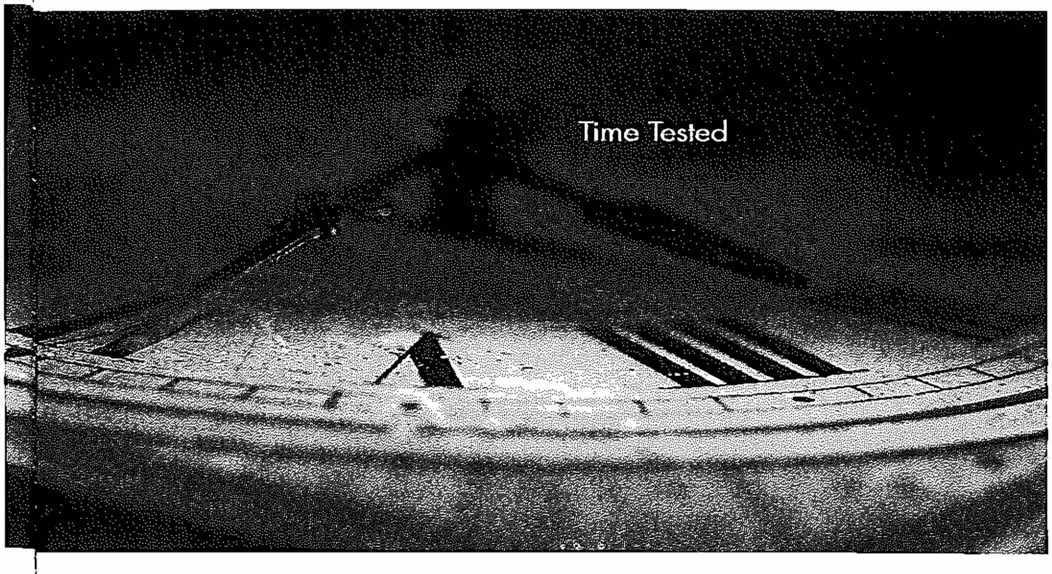
## To Our Business Partners



Virtually every measurement system involves the element of time. In this year's letter, we will discuss the relevance of time in measuring results and how we focus on the value of long-term thinking.

In December new business was disappointing, but investment returns were excellent. Financial results in the fourth quarter set company records, and 1997 was an excellent year. This past summer our camp insurance business suffered more large losses than usual; however, we enjoyed good results among most of our other lines of business. Since the Northridge earthquake in January 1994, the earthquake business has been great, yet current prices have declined to levels which suggest many have forgotten what can happen. The insurance industry has experienced a cyclical softening of prices since 1987... much longer than any previous cyclical downturn. Maybe it's not a coincidence that the investment cycle has enjoyed an equally impressive run in the opposite direction. Monthly, quarterly and even annual results do not necessarily mean much if your goal is to build shareholder value over a long period of time. Yes, 1997 was a good year, but we are especially proud to report that in the past five years, we have compounded book value per share at a 26% rate, and since our initial public offering in 1986, we have compounded book value per share at a 31% rate.




## 1997 Results

In spite of a very difficult property and casualty insurance market, our results in 1997 set records in just about every measure. For the sixth consecutive year and eleven of the last twelve, we reported underwriting profits with a combined ratio of 99%. Earned premiums grew only 8% to $332.9 million; however, investment income increased 34% to $68.7 million. The strong investment environment also allowed us to realize $15.8 million in investment gains. Total revenues increased 14% to $419.0 million. Net income was $50.4 million, or $8.92 per diluted share. In addition, the net unrealized appreciation of our investment portfolio increased $41.5 million, resulting in comprehensive income of $91.9 million. Also during 1997 we further strengthened an already strong balance sheet: total investments increased to $1.4 billion; provisions for loss reserves continued to be, in our opinion, very strong; we raised $150 million in 49 year trust preferred securities and increased shareholders' equity by 33% to $356.8 million, or $65.18 per share.

For many years we have spoken of the importance of measuring growth in book value. This year the accounting profession recognized the same thing by adopting the concept of comprehensive income. This is a measure of total performance because it includes both net income and changes in unrealized gains or losses. Over the past five years, our net income amounted to $173.8 million; cumulative unrealized gains were $73.1 million; and comprehensive income was $246.9 million. The variations year to year are shown below:

### Comprehensive Income
*(dollars in millions)*

| | Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 1993 | 1994 | 1995 | 1996 | 1997 | Total |
| Net income | $ 23.6 | $ 18.6 | $ 34.5 | $ 46.7 | $ 50.4 | $ 173.8 |
| Change in unrealized gains (losses) | 10.3 | (28.7) | 40.3 | 9.7 | 41.5 | 73.1 |
| Comprehensive income (loss) | $ 33.9 | $ (10.1) | $ 74.8 | $ 56.4 | $ 91.9 | $ 246.9 |

These results point out two significant facts. First, unrealized gains represent an important part of the value created for shareholders. In the past five years, almost 30% of our comprehensive income came from this source. Secondly, and certainly not to be forgotten, changes in unrealized gains from year to year can be quite unpredictable. Having a long-term view is especially important when looking at investment results.

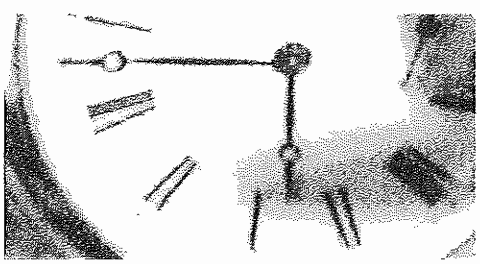
## New York Stock Exchange

In June 1997 we were listed on the New York Stock Exchange. While we were generally pleased with NASDAQ and certainly enjoyed a great deal of support from NASDAQ market making firms, it was our desire to try to reduce the spread between the bid and asked prices of our stock. We believe this has occurred and we are pleased to be a NYSE listed firm. We continue to see no valid reason to split our shares. (In fact, NYSE fees are based on number of outstanding shares, so we save money by not splitting.) However we would caution our fellow shareholders and


potential new shareholders to be thoughtful when buying or selling our stock. If you see a $2 spread between the bid and asked prices, remember that it represents only a 1.3% spread on a $160 stock price. Most transactions in other securities are likely to be more expensive. Additionally, we enjoy a very loyal base of shareholders and have low share turnover. As a result, the stock price can move on very little volume so it is wise to be patient when buying or selling.

## Intrinsic Value

During 1997 our share price increased from $90 to $156, a 73% increase. As previously mentioned, our business results were the best ever, and book value grew by 33% per share. Ideally, the growth in share prices and the growth in intrinsic value should be identical. This rarely happens in the short term but should occur over long periods of time. We are hopeful that the increase in our share price in 1997 represents an alignment of our share price with the long-term growth in our intrinsic value.



We want to share with you important information about your company so you can estimate its intrinsic value. We have no desire for our stock to trade at levels either significantly higher or lower than its intrinsic value. Unfortunately there is no exact science in determining that number. Today the stock is priced higher in relationship to many determinants of value than in previous years; however, we remain committed to building book value at a 20% annual rate, and we think the Company will continue to be an excellent investment for those with a long-term view.

## Accounting Cycle

Due to the number of estimates required in the insurance accounting cycle and management's great leeway in setting those estimates, quarterly and annual accounting periods do not reflect the complete picture of an insurance business. Only when viewed over a much longer time period can you begin to determine accurate results.

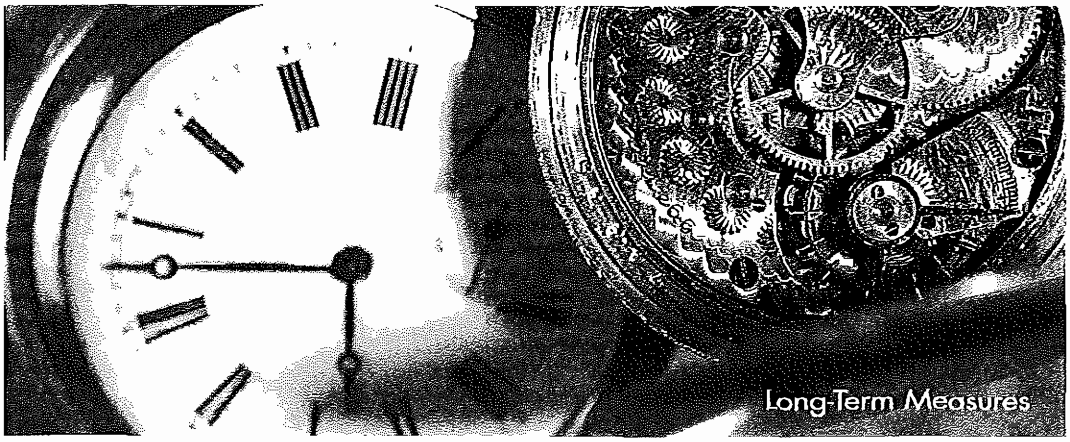
Insurance for property along coastal areas subject to hurricanes is more at risk during hurricane season, which runs from June to November. Likewise, hurricane activity varies greatly from year to year. While 1997 was a very mild season for hurricanes, that certainly doesn't have much meaning when trying to estimate the risk for the 1998 season. The same applies to insurance for earth-

quakes. The ground has been relatively still since 1994 when Northridge shook violently; yet surely another earthquake will occur. Based on the declining prices for this coverage, you would think the property and casualty insurance industry has no memory.

Other insurance products like professional liability coverages require a long period of time for claims to be reported and paid. Long-tail insurance represents yet another problem for the annual accounting cycle. While premiums are collected today, claims are not paid for many years. At the end of each accounting cycle, estimates are made with regard to outstanding losses. These estimates are just that, estimates. They may be too high or too low but never exact. Unfortunately, many companies report lower losses than are actually occurring in order to inflate current income. This cannot go on forever; companies can underestimate reserves, but claims are settled in cash.

### Loss Reserving

We have often described our philosophy in setting conservative loss reserves. Our standard has consistently been to set reserves at a level which we believe are more likely redundant than deficient. The very nature of the insurance business is that surprises in loss occurrences will happen from time to time. Usually surprises represent bad news. Unfortunately, we are not immune




to surprises. But we have been successful in avoiding a negative impact on our loss reserves from these surprises because we establish reserves to cover that unpredictable but inevitable event. We seek to allow for that by establishing a margin of safety in our reserves. This policy again proved sound in 1997 when we determined that it would be prudent to add an additional $28 million to our reserves for environmental and toxic tort claims. While our existing reserves were more than adequate to cover this development, we certainly thought our previous estimates had been sufficient, and we can say the same today. We think the specific reserves for environmental and toxic losses are adequate but if they are not, we have made provisions which give us a margin of safety.

### Investments

Our investment activities continue to be very important to our success in building shareholder value. In 1997 the stock market was unusually strong and interest rates trended down which helped us achieve exceptional investment results. The total returns from equities were 31.4% and from fixed maturity securities were 9.2%. As a result our portfolio produced a total return of 12.8%. Over the past ten years our total weighted average annual return was 10.3%.

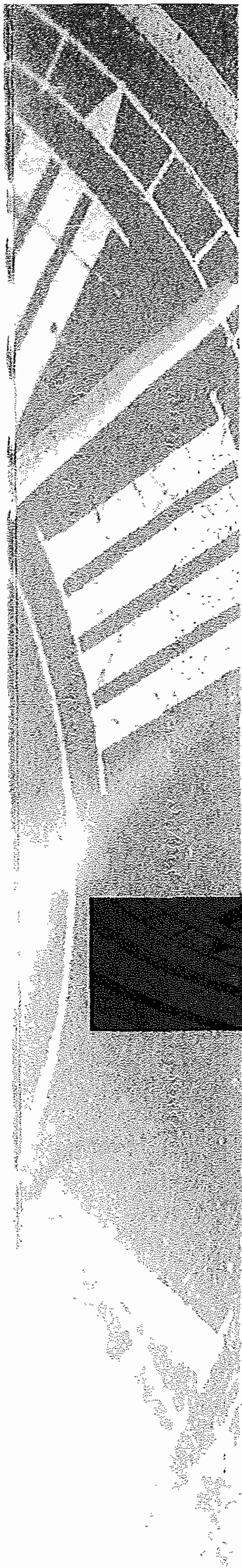
With the stock market trading at all time highs, we are cautious and concerned about where the market might be headed; however, we have never tried to time the market. We focus on individual securities of companies which we believe will generate good returns, and we invest in these companies at what we believe to be fair values. Fortunately, we own many good companies which are building value and we continue to invest in more which we believe will add value in the future.

The general decline in interest rates has added to the total return in our fixed maturity securities. This is certainly a double edged sword as lower interest rates will make it more difficult to earn high rates of return on this portfolio in the future. With our fixed income portfolio, we will continue to invest in very high quality securities with fairly short durations. We will continue to take advantage of our tax position to invest in tax-exempt securities where they will add value.

### Acquisitions

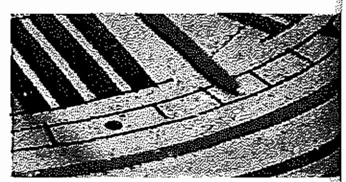
Over the past several years, we have developed our business through the growth of existing businesses as well as through acquisitions. In January 1997 we raised $150 million to help fund future acquisitions, so it seems appropriate to look back at our acquisition history and evaluate our performance. (Also, an interested investor asked us to do so.)

Our most important acquisition was the purchase of Shand Morahan and Evanston Insurance Company. We initially invested in 1987 and acquired the remaining interest in 1990. Our total investment was less than $85 million.



When we acquired the company, it was suffering from several major problems as a result of the very competitive professional liability insurance market of the early 1980s but was well on the way to solving them. Since we purchased the company, we have received more than $83 million in dividends. In 1997 the business generated over $100 million in earned premiums at a small underwriting profit and investment income on a portfolio of almost $650 million. The current equity in this business is approximately $210 million. We wish we could do many more transactions just like this.

In 1989 we acquired a book of business from the Rhulen Agency which placed program business in an unrelated insurance company. In the years following this transaction, we transformed the agency business into a full service insurance company which now trades as Markel Insurance Company. In addition to the original acquisition, we have contributed an insurance company to this business for a total investment of approximately $57 million. No dividends have been received from this investment, although we expect to see them in the future. In 1997 the business reported earned premiums of $68 million and an improving, but still unacceptable, underwriting loss. At this point in time, we believe the difference between our reported underwriting loss and an underwriting profit is equal to the difference between the actuarial point estimates and our more conservative margin of safety. The investment portfolio generated by this business amounts to approximately $178 million. We have not yet achieved our return on investment objectives with




this business; however, our total return in 1997 was approximately 15%. In spite of the less than desired return, we believe this business will be a significant contributor in the future.

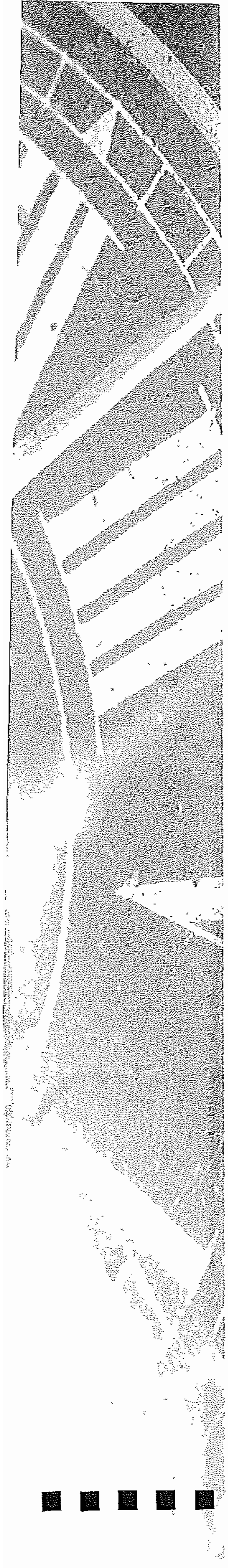
The Lincoln Insurance Company was acquired for $24 million in 1995. Our purchase anticipated merging selected business into our excess and surplus lines unit and liquidating the balance of the business. In the short time we owned the company, we received a total of $35 million in dividends and proceeds from the sale of the licenses. We continue to manage the runoff of $22 million in claims liabilities with a like amount of invested assets. In 1997we enjoyed almost $6 million in premium volume from this acquisition. Our return on this investment was good, but unfortunately it is nonrecurring.

Our most recent transaction was the purchase of Investors Insurance Group in late 1996. This company also had a difficult history and found itself with several problems. About a year before we acquired the company, they began their third reorganization in five years. We knew and respected the new management team and believed it could become an important part of our organization. The purchase price was $38 million. In 1997 this business generated approximately $30 million in earned premiums with a combined ratio of slightly over 100%. Invested assets are approximately $160 million. Total return on our investment in 1997 was about 18%. At year end 1997 the equity in this business amounts to $46 million. While it is probably too early to make a meaningful evaluation of this transaction, we are clearly pleased and excited about the opportunity that Investors brings to us.

We continue to believe that future acquisitions will be an important part of our growth and development. We look at many opportunities but find few that meet our requirements. We expect an acquisition to have the ability to earn underwriting profits and contribute to our goal of building book value at a 20% annual rate. In addition over the years we have developed a strong corporate culture; one we call *The Markel Style.* In any acquisition, we expect the people involved to embrace and be comfortable with our corporate values.

## Markel Associates

*The Markel Style* is our value system. It describes how we conduct our business. Among the values we believe in are "a pursuit of excellence, honesty and fairness in all of our dealings...a respect for authority but a disdain of bureaucracy." Our organization today includes 830 associates. With such a large group, it is not easy to build a strong corporate culture; however, it has been and will con-



tinue to be an important part of our success. One of the primary reasons for this success is that we have a large group with long tenure. Over 25% (227) of our associates have been with the company for ten years or more. Over forty associates have been with the company for twenty years or more.

Another important fact is that all Markel associates own stock in the Company, and many have very significant investments. Several years ago we essentially eliminated the use of our stock option plans and instead have offered our associates stock purchase plans with subsidized interest on loans used for the purpose of purchasing Company stock. This past year over 250 associates participated in the plan and purchased over $6.3 million in stock.

Our goal, of course, is for our associates to be and feel like owners of the Company. We believe this will promote *The Markel Style,* encourage everyone to work hard and enjoy what they are doing and focus on building long-term value.

We recently lost a much loved associate, Jim Brinson. Affectionately called "the Governor," Jim began his career at Markel in 1948. Jim was always a big producer, no matter what we asked him to sell. At age 75 he asked if he could cut back his work schedule to 30 hours a week. He continued this schedule until his death at age 82. Jim exemplified *The Markel Style.* Associates like Jim who embrace our core values are the reason that we are successful.

*Clockwise from left to right: Anthony F. Markel, Darrell D. Martin, Steven A. Markel, Alan I. Kirshner*

## Profitable Growth

In managing our company we have consistently tried to focus on generating long-term results. We have sought to build shareholder value not just for the next quarter or year but with a view to the next ten or even twenty years. In contrast, today's fast paced world is one where almost everyone is focused on today's activities and results. Typical measures of success are often oriented to short-term results. The line from a Broadway play, "Instant gratification just isn't quick enough" typifies this short-term focus. But today's instant gratification will be long forgotten five years down the road.

The insurance business continues to be competitive, and profitable growth is extremely difficult to achieve. Anyone can write more business if they are willing to meet unrealistic pricing demands and operate at inadequate returns, or even a loss. Those willing to optimistically estimate loss experience can even fool themselves for a short while. But in the end, these strategies do not work. Losses must be both accounted for and ultimately paid.

While we would prefer to grow quickly, the current environment demands patience. Those who resist the temptation to write business recklessly will be rewarded. Ten years from now, we want to be able to tell you, our shareholders, of additional years of record earnings and exceptional growth in shareholder value. Underwriting profit, not growth, will continue to be our standard.

We thank our Markel associates for their hard work, dedication and commitment to success, and we thank you for your loyal support, encouragement and confidence in our future.

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1998

# TO OUR BUSINESS PARTNERS

We are pleased to report another busy and successful year. In 1998 we extended our record of success in earning consistent underwriting profits and superior investment returns. While we will review our company's annual progress in this report, we will also discuss some important long term industry trends which we expect to affect us. Also, without making too many predictions, we will try to look toward the future, and give you some idea of what we expect.

Overall our 1998 results were extremely good. While premium growth was small, given the competitive insurance marketplace, bottom line profits were very solid. Underwriting profit exceeded $5 million and our combined ratio was 98%. Investment returns were excellent as we earned a total tax equivalent return on our portfolio of 8.9%. Earnings per share amounted to $10.17, comprehensive income was $12.07 per share, and book value per share grew 18% to $77.02.

## Underwriting

The property and casualty insurance market remains extremely competitive but we continue to maintain our underwriting discipline. The net effect is that our premium growth has been very modest over the past few years and 1998 was no exception. In 1998, gross written premiums increased just 3% to $437 million and net earned premium was flat at $333 million. These small changes in total volume do not accurately reflect the vital efforts of our associates in eliminating unprofitable business, fighting "tooth and nail" to keep existing business in the face of fierce competition, and developing and expanding new business opportunities.

We continue our focus on maintaining adequate price levels and disciplined risk selection so that we can earn underwriting profits. In 1998 we reported a combined ratio of 98%, a result slightly better than last year.

## Loss Reserves

Our practice is to establish current year reserves on a conservative basis because loss data emerging during the first underwriting year is somewhat limited. Over time, underwriting results for each specific year become more apparent and reserve levels can more easily be set. As in prior years, we have enjoyed the benefit of finding our actual loss experience to be better than originally estimated. We believe that our total loss reserves are as strong today as ever.

In reviewing our loss experience over the past few years, we found that some lines of business were significantly more profitable than we originally thought. On the other hand, we continue to learn bad news about the ultimate costs associated with asbestos and environmental claims. Because of these events, we have reallocated reserves among different business units. While these shifts occurred, we believe our overall level of loss reserves remains sufficient to cover our exposures.

There can be no doubt that our strong commitment to underwriting profitability, coupled with a conservative approach to setting loss reserves, underpinned the Company's success over a number of years. The underwriting results in 1998 represent the seventh year in a row we have reported an underwriting profit and the twelfth year out of thirteen since our initial public offering in 1986.

## Investments

At year end our investment portfolio was $1.5 billion, an increase over the prior year of 5%. During the year, investment markets were quite exciting. The bond market enjoyed the continuation of the broad trend of lower interest rates causing bond prices to be generally higher. The change throughout the year, however, was certainly not smooth. In addition, many events, including problems in Russia and Brazil, the failure of prominent hedge funds, and the Asian meltdown produced very different results among various segments of the fixed income market. Quality and liquidity proved to be extremely valuable. Despite the turbulence we are quite pleased with our fixed income performance.

The stock market was no less interesting, as in spite of a brief September correction, equity prices continued to rise. It is incredible that the S & P 500 index has increased by more than 20% for the fourth year in a row. We have trouble believing that the underlying intrinsic value of the companies represented increased at the same rate. Consequently, as business people making business judgements, our portfolio is not weighted toward the securities in the index. Our 13.3% return on equities, although solid, was short of the index return. We currently own no high technology or internet stocks (the valuations of which we also don't understand). We continue our long-standing practice of careful selection and extremely low portfolio turnover as it serves our purpose of owning good companies for the long term, and maximizing the total after tax return to our shareholders.

## Book Value Growth

Our primary financial goal is to increase book value over the long term on a per share basis. In 1998 book value grew from $357 million to $425 million. On a per share basis book value increased 18%, to $77.02 from $65.18. Our goal is to compound book value at a 20% annual rate. In 1998 we just missed the mark, however, we do expect some volatility in this measure on an annual basis. In the past five years, a more meaningful period and the one we use to calculate incentive compensation, book value grew at a 23% compound annual rate on a per share basis.

Several years ago we discussed our "model for profit." This model helps one understand how we believe we can compound book value at a 20% rate. Simplistically, if we do not lose anything in the underwriting operation, and maintain $4 in investments for every $1 in equity, earning a 5% after tax total return, then we will grow book value at a 20% rate. At year end our investments totaled $1.5 billion and shareholders' equity was $425 million. This represents only $3.50 in investments for every $1 in equity. This is the obvious result of growing book value at a rate faster than the investment portfolio. As discussed later, the acquisition of Gryphon Holdings, Inc. provides additional investment leverage and positions us to work toward compounding book value at 20% in the future.

## Gryphon Acquisition

One of the most important events of the year for us was the decision to purchase Gryphon. This transaction consumed a great deal of energy throughout the year, and concluded with an agreement to purchase the company for approximately $150.7 million and the assumption of $55.0 million in debt. Gryphon is an insurance holding company that owns three insurance companies: Associated International Insurance Company based in Woodland Hills, California; Calvert Insurance Company with offices in Hoboken, New Jersey; and The First Reinsurance Company of Hartford which operates out of Chicago. Together these companies control approximately $200 million in annual premium volume.

Gryphon has excellent franchises in property subject to earthquake risk, professional liability insurance for architects and engineers, as well as directors and officers liability insurance and other miscellaneous professional coverages. The company was also active in many other programs with very inconsistent results. In today's environment, it is very difficult for a small company to operate successfully in multiple products across many states. As with other companies in similar circumstances, Gryphon was burdened with too much overhead and too much bureaucracy. While the company tried to grow its way out of its problems, this strategy proved to be difficult in the current competitive environment.

The process of integrating Gryphon into the Markel organization has just begun. We expect that each line of business that we continue to write will be managed by an existing Markel operating company. For example, the property division writing California earthquake coverage will become a business within the Essex Insurance Company where we currently write similar coverages. The architects and engineers coverage, as well as the Chicago operations specializing in directors and officers coverage, will become part of the Shand/ Evanston team where we have a great deal of expertise and believe we can add value and grow these businesses.

Gryphon did not enjoy underwriting success. In fact, the company incurred significant underwriting losses in each of the past four years. These results stemmed from high operating costs, a lack of management focus, inadequate loss reserves, and attempts to develop new business in areas where the company lacked sufficient expertise. We believe that as part of Markel this will quickly change. As the unprofitable businesses are run off and underwriting standards are reviewed, we expect Gryphon's premium volume to decline, probably by as much as 50%; however, more importantly, we expect the remaining businesses to ultimately produce underwriting profits.

As part of our review of Gryphon we determined that the company's loss reserves were set somewhat optimistically. As a result, Gryphon took an additional charge in the fourth quarter to set its reserves on a more realistic basis. At year end we think the company's reserves are adequate (although not yet with the margin of safety we would prefer).

In looking at the investment side of the operation we also see significant opportunity. Gryphon has an investment portfolio of approximately $400 million, invested in high quality fixed income securities with fairly short durations. Markel will also be able to add significant value in the management of the investment portfolio and overall investment leverage will improve. On a pro forma basis at December 31, 1998 we now have investments of $1.8 billion and equity of $425 million which represents slightly more than our targeted level of investment leverage of $4 in portfolio for each $1 in equity.

When we achieve underwriting profitability, we can take full advantage of the additional investment leverage, and the acquisition will help us to compound book value at a 20% rate. The additional premium will better utilize our growing capital base and the additional portfolio provides the balance sheet leverage we seek to maintain.

We believe we start 1999 in an excellent position to continue to build shareholder value. As always, for the actual results, we must wait and be patient.

## Industry in Transition

The property and casualty insurance industry remains very competitive. Industry premium growth has been slow, returns on equity from operations are at unacceptably low levels and the industry has too much capital.

There are more than 3,000 insurance companies competing for business. Price levels continue to decline and it's hard to remember when the industry last earned an annual underwriting profit. Many observers also believe that loss reserves are now inadequate. Compensating for weak operations, the industry has been bailed out by rising investment portfolio values from the decline in interest rates and rising stock prices. In addition, many companies are manufacturing earnings per share though creative reinsurance arrangements. This environment will not necessarily change quickly, however, it will change.

Over the past several years there has been a continued change among the companies which lead the industry. Many of the industry's former leaders have been acquired or substantially reorganized. Merger and acquisition activity has picked up among both large and small companies as the industry consolidates. We expect this trend to continue.

In 1986 when we completed our initial public offering, we trumpeted our small size, our spontaneity and flexibility, our ability to make decisions quickly, and our customer focus. These attributes undoubtedly contributed to our success. Today we are by most measures at least ten times larger than when we went public. Can we maintain these strengths and values as we continue to grow? The acquisition of Gryphon will add $100 million in premium, $300 million in incremental investment portfolio and initially more than 100 new associates. How long will it take this group to embrace the Markel Style? As we grow and meet the new challenges of our changing industry, we recognize the importance of sticking with and communicating to our new associates the important, common sense principles which guided us in the past.

The industry is facing many challenges and we expect as many or more changes in the next decade as we saw in the last. Neither inadequate pricing, nor inadequate loss reserves can last forever. These problems must be addressed and resolved and opportunities exist for Markel to be part of the solution. Interest rates are currently as low as they have been in many years. At current levels, many insurance companies will see a significant decline in investment income and returns on equity could drop to even lower levels. In this environment, we expect to see a continuation of industry consolidation.

All of these developments spell opportunity for Markel. While growth is not one of our strategic objectives, we expect to grow in the future. We want to provide excellent customer service, quality products, underwriting profits, and superior investment returns. All of this to build shareholder value.

## The Markel Style

As an organization, one of our core strengths has been our strong values; values we articulate in The Markel Style. Often organizations have trouble balancing the different demands from clients, associates and shareholders. Some would believe that every decision is a trade off among these different interests. We disagree. Our goal is to make decisions which support all constituencies. For example, associates become owners through payroll stock purchase programs and loan plans, as opposed to dilutive stock options. Additionally, our incentive compensation systems are designed to reward individual achievement. Our performance culture builds financial strength which our clients can count on. Creating an atmosphere in which people can reach their personal potential is much easier when the business is growing and successful. Success breeds success and we have designed Markel to be successful. We also know that just as soon as we become complacent, just as soon as we start to think we're pretty good, then we're headed for trouble. We pledge not to become satisfied with what we've done in the past. We set long term goals and we work toward them every day. We've come a long way and we are excited about the road ahead.

In closing, we would like to express our deep appreciation to Prem Watsa , who resigned from our Board of Directors in November, for his loyal service and keen advice over the years. Your Company is much stronger today because of Prem's contributions.

Additionally, we welcome Tom Gayner to the Board. Tom joined Markel in 1990 and has contributed both in the management of our equity portfolio and his common sense business advice.

Thank you for your support.

Alan I. Kirshner

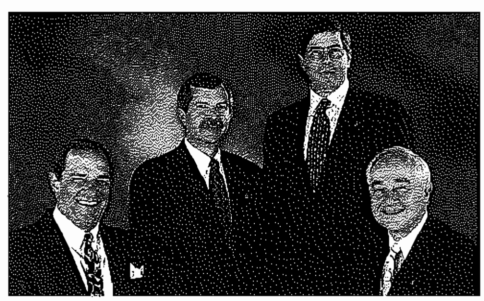
Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel

Anthony F. Markel
*President and Chief Operating Officer*

Steven A. Markel
*Vice Chairman*

Darrell D. Martin
*Executive Vice President and Chief Financial Officer*



*Clockwise from left to right: Anthony F. Markel, Darrell D. Martin, Steven A. Markel, Alan I. Kirshner*

# TO OUR BUSINESS PARTNERS

We measure our success in building shareholder value by focusing on growth in book value per share over the long term. Book value per share declined 11% to $68.59 due to disappointing investment results. In spite of that, 1999 was a very good year overall. Our core underwriting results remained exceptionally good at virtually every operating division in the Company. This is a real tribute to our underwriters given the very difficult market conditions they faced. Additionally, we should remember that over the past five years we compounded book value per share at a 22% annual rate. While it would be pleasant to report consistently improving results, it would be unrealistic given the nature of our business. Insurance and financial markets are volatile by nature and the volatility itself creates significant business opportunities for Markel.

The year also included the acquisition and amalgamation of Gryphon as well as the announcement of the plan to acquire Terra Nova (Bermuda) Holdings, Ltd. and the agreement to acquire the renewal rights to Acceptance Insurance Companies' Scottsdale business. Despite the setback in our book value growth during 1999, we believe we continued to build the intrinsic value of the company and positioned ourselves to take advantage of even more opportunities in the future.

## 1999 Financial Review

After several years of very modest growth, operating revenues increased 23% to $524 million in 1999. While the acquisition of Gryphon was responsible for the largest part of this increase, in the closing months of the year we saw significant increases in written premiums in virtually every line of business. In the fourth quarter, excluding the Gryphon acquisition, written premiums increased 26%. This is a very positive sign and we are certainly hopeful it will continue.

Earned premiums increased 31% to $437 million and we had a small underwriting loss with a combined ratio of 101%. This was the result of excellent performance from almost every operating division enabling us to partially offset the costs associated with acquiring Gryphon. Our core business units enjoyed a combined ratio of 96% exclusive of the Gryphon business. This is truly excellent performance and compares favorably to our 1998 combined ratio of 98%.

Net investment income increased 23% to $88 million primarily due to the growth in the investment portfolio as a result of the Gryphon acquisition. In the fourth quarter, to create tax savings, we realized $10 million in investment losses. At the same time we replaced the bonds sold with bonds of similar quality and duration. As a result, we reported $1 million in net losses from the sale of investments in 1999 as compared to $21 million in realized gains in 1998.

The brightest spot of the year was the outstanding underwriting performance of our core insurance company subsidiaries.

Net income was $41 million compared to $57 million last year. Earnings per share were $7.20 on a diluted basis compared to $10.17 last year. As a result of the reduction in the market value of our invested assets, we had a comprehensive loss of $40 million compared to comprehensive income last year of $68 million. Shareholders' equity declined 11% to $383 million, or $68.59 per share.

## Excellent Results From Core Underwriting Businesses

The brightest spot of the year was the outstanding underwriting performance of our core insurance company subsidiaries, which produced an enviable 96% combined ratio in spite of another year of intense, irrational competition. This is clear testimony to our straightforward and continuous focus on underwriting profits and the unwavering dedication of our associates to that goal.

The Excess and Surplus Lines units, Essex (Excess and Surplus Lines), Evanston (Professional and Products Liability) and Investors (Brokerage Excess and Surplus Lines) generated a 94% combined ratio while showing some solid, well-controlled growth.

Essex volume grew to $186 million from $122 million as a result of the smooth assumption of the Gryphon DIC property book and moderate increases in their other core lines—property, casualty, inland marine and ocean marine. Steve Vaccaro, President of Essex, and his troops continue to produce results that are the envy of the industry.

Evanston, led by continued increases in its Employment Practices Liability volume, along with the addition of a book of Errors and Omissions business acquired as a part of the Gryphon transaction, grew to $154 million from $124 million. In addition, they successfully experimented with some creative new production sources. At year end, Mike Rozenberg accepted sole responsibility for this subsidiary, as a result of Paul Springman's promotion to President, Markel—North America. Mike has been Paul's partner in the management of Evanston for over eight years, so the transition will be completely seamless.

In October, Jeremy Cooke, President of Investors, accepted the Chief Operating Officer role of Terra Nova, passing the mantle of leadership on to Rod Ayer, previously Senior Vice President. Under the combined leadership of Jeremy and Rod, Investors put impressive numbers together exhibiting both a volume increase ($85 million from $65 million) and a gratifying underwriting profit.

The Specialty Admitted subsidiaries, Markel Insurance Company (Specialty Programs) and Markel American Insurance Company (Specialty Personal and Commercial Lines), made notable strides in both size and profitability during 1999 as the combined ratio improved to 101% from 102% in 1998 and 110% in 1997.

Markel Insurance Company, which has historically produced outstanding loss ratios, aggressively attacked its expense ratio through a combination of significant expense reductions, a new corporate structure with emphasis on sales and marketing, and some creative new product experimentation. We are comfortable that Britt Glisson and his energized staff will significantly contribute to the underwriting profits this year and for many years to come.

Markel American Insurance Company, now led by Timberlee Grove, who was promoted to President in August 1999, also had an outstanding year of growth and profitability. Their operation, bolstered by the acquisition in April 1999 of a book of yacht business, grew to $50 million in volume. They also completed the transition to a completely autonomous unit with all product underwriting and support services under the same roof in Pewaukee, Wisconsin.

As important as acquisitions have been, and will continue to be, we could not expand our horizons without the knowledge and comfort that our core operations are well managed and will continue to produce the outstanding results that we have come to expect. We are fortunate and extremely grateful to have this talented, motivated group of associates.

## Investment Philosophy and Results

Our fixed income portfolio, the largest part of our investment portfolio, has a duration that ranges between 4 and 5 years. At the beginning of 1999 we were earning a tax equivalent yield of approximately 6.1%. By year-end, this yield increased to 7.1%. This rise in yield caused a decline in the value of our portfolio. Unrealized gains declined $67.3 million and we realized losses of $13.7 million. This market value decline was about 6% and almost completely offset our return from the investment income of 6.9%, resulting in a total return on our fixed income portfolio of only .9%.

Changes in interest rates cause changes in book value, which can be extreme in any particular year. However, over a longer period of time, the fluctuations in value related to interest rate movements tend to have only a modest impact on our results. This is why we prefer to measure our performance over five year periods. Additionally, the duration of our fixed income portfolio is conservatively matched to the duration of our liabilities and is well within a reasonable tolerance for interest rate risk.

We believe that in the long term we can significantly enhance shareholder value by allocating significant investment funds to common equities. We do not think about risk in the context of short-term volatility but rather in the context of a permanent loss of capital. We buy shares of companies where we believe the business will earn good returns on capital and which are being run by honest and talented, shareholder oriented managers who are building the value of the enterprise. We expect to share in the increased value of the business over the long term. (We hope you, as a shareholder of Markel, have a similar view with regard to your investment.) Our result in equity investing was disappointing in 1999. In most cases we are pleased with the companies we have selected and believe the business fundamentals are sound even though stock market prices have suffered.

We concentrate our equity portfolio in relatively few securities. At year-end our top five positions represented over 32% of our portfolio and the top 20 represented 71%. While diversification might reduce short-term volatility, we do not believe it maximizes long-term total return. We believe we can earn the best returns by concentrating our focus and our portfolio in promising areas where we have the best understanding and knowledge. In 1999 our concentration in other insurance stocks contributed to our disappointing results, and our failure to invest in the red hot portions of the NASDAQ market prevented us from enjoying the well advertised, but narrowly based, returns of the bull market.

In 1999 our total return on equity investing was a loss of 10%. This compares very unfavorably to the major indexes, which include the Dow Jones Industrial Average (up 25%), the S&P 500 (up 20%) and the NASDAQ Index (up 86%). Over the past five years our performance in equities was up an average of 14%, and for the past ten years 13%. These results are obviously much better than 1999 and are

We invest with a serious regard
for the risks we assume.

results which we believe will in fact be more like our long-term performance in the future. In managing equity investments, we do not seek to match or beat any specific market index. In addition to selecting individual businesses with good returns on capital as well as honest and talented management, we seek to invest at prices that allow for some margin of safety for our inevitable mistakes in judgement about those attributes. Our goal as investors, rather than traders, is to earn returns similar to those intrinsically earned by the companies themselves in the course of conducting their business. We invest in the equity markets because over time we expect to earn more than we would earn by investing in the fixed income market, always attempting to do so without taking on significant risks of permanent loss of capital.

We have avoided the technology sector due to our view that many of the businesses represented by the stocks that might be exciting trading vehicles were not clearly businesses with sufficiently durable returns on capital, management attributes, and reinvestment opportunities to qualify for what we seek in equity investments. While you as a shareholder may be justifiably unhappy about the opportunities that have passed us by so far, we think you may also someday appreciate the fact that we have not put any of your capital at risk in stocks with valuations that make ownership an extremely high risk proposition. The seesaw of risk versus reward has been all focused on the reward side with too little regard for risk. We invest with a serious regard for the risks we assume.

## Acquisition of Gryphon

In January 1999 we completed the acquisition of Gryphon. This purchase was intended to provide profitable premium volume as well as investment opportunities at a reasonable cost. In the first year of this transaction we believe we are very much "on schedule as planned," however it remains too early to proclaim the deal a success.

Our first goal was to acquire profitable premium volume. We completed our re-underwriting and currently expect the acquired business to contribute about $70 million in gross written premium in the year 2000. We also expect this business to generate underwriting profits. This premium forecast is slightly short of our original goal of $80 to $100 million.

A second goal was to re-underwrite and discontinue the unprofitable lines of business as quickly as possible. We completed this very effectively as we eliminated all of the business that we believed caused problems for Gryphon. The underwriting loss on this run-off business was somewhat higher than we originally estimated, however, this cost is now behind us.

Another goal was to increase our investment leverage. With the addition of $300 million to our portfolio, this goal was achieved. Because interest rates increased throughout the year, we did not earn the returns we anticipated on this portfolio, however the investments are productive and will be with us for years to come.

The acquisition price of Gryphon was $146 million. Because a majority of the business is being transferred to other Markel business units, we have sold as licensed shells some of our insurance companies to recapture as much of our capital investment as possible. We sold the Calvert Insurance Company for $22 million in August 1999 and although not directly related to Gryphon, sold Investors Insurance Company as a shell for $54 million in January 2000. These transactions effectively enable us to re-allocate $76 million in capital. In addition, the gain on Calvert reduced goodwill by $6 million and the sale of Investors will represent a gain of $8 million.

Our final objective is to manage the claims process in an effective manner and to maintain appropriate loss reserves for our outstanding exposures. In last year's report we said that we believed the Gryphon reserves were adequate but not with the margin of safety we would prefer. To date we have made a great deal of progress in evaluating, reserving and settling the outstanding claims. As might be expected, there have been some areas where we have had good news and some where we have been disappointed. Unfortunately, we had to deal with several lines of business where Gryphon did an extremely poor job of managing its risk. As a result we have continued to strengthen Gryphon loss reserves but are still slightly short of our desired margin of safety.

The process of merging the Gryphon organization into Markel involved a great deal of work by numerous associates throughout the organization. To the extent that this has prevented us from doing other things, it certainly represents an additional cost. However, we learned a great deal from this experience and developed new skills. We appreciate the extraordinary efforts of so many of our associates to make the Gryphon acquisition successful.

## Planned Acquisition of Terra Nova

In August 1999 we announced an agreement to acquire Terra Nova (Bermuda) Holdings, Ltd. Terra Nova is a specialty property and casualty insurance and reinsurance company with headquarters in Bermuda and principal operations in London. The Terra Nova business is split between direct insurance and reinsurance; the London market and Lloyd's; and marine and non-marine. It largely writes short tail business.

Throughout the fall we worked with Terra Nova to begin the integration process and to complete the transaction. Unexpectedly, Terra Nova reported significant losses for the fourth quarter and for the year. As a result, in January we renegotiated this transaction and agreed to revised terms. The transaction is currently expected to close on March 24, 2000.

In purchasing Terra Nova we believe we will acquire a high quality international insurance business at a fair price. While the company suffered from some recent problems and will probably finish the year 2000 with a combined ratio in excess of 100%, we believe that its people will embrace the Markel Style and return their focus to consistently earning underwriting profits.

The total purchase price will be approximately $660 million. Approximately half is being paid in cash and half in securities. We expect to issue approximately 1.8 million common shares to complete this transaction. In addition, we will issue contingent value rights which are intended to increase the likelihood that a Terra Nova shareholder will be able to realize a minimum value of $185 for each share of Markel received. While the potential cost is very real, the contingent value rights will become worthless if our stock consistently trades over $185 in the next 30 months. We are always thoughtful about the cost of issuing stock and believe the contingent value rights were an effective way to complete this transaction and minimize the number of shares we would need to issue.

Terra Nova is slightly larger than Markel. In 1999 its gross written premium was $865 million, and at December 31, 1999 its investment

One of our strengths is that we have an experienced, talented and motivated staff.

portfolio was $1.5 billion and its shareholders' equity was $439 million. Terra Nova has 698 associates in its organization. Acquiring Terra Nova gives Markel shareholders significant increases in premium volume and investment portfolio per share as shown on the following table. We believe this additional operating and financial leverage will add value to the company, although it will only do so when we achieve underwriting profitability. Book value per share also increases substantially, however, this is simply because we are issuing additional Markel stock at a price in excess of our book value.

**MARKEL AND TERRA NOVA COMBINED SELECTED PRO FORMA INFORMATION DECEMBER 31, 1999**

*(in millions, except per share data)*

| | Markel | Pro Forma Combined |
|---|---|---|
| Premium Volume | $ 595 | $ 1,460 |
| *Per Share* | $ 106 | $ 186 |
| Investment Portfolio | $ 1,623 | $ 3,003 |
| *Per Share* | $ 290 | $ 409 |
| Shareholders' Equity | $ 383 | $ 677 |
| *Per Share* | $ 69 | $ 92 |
| Investment Leverage | 4.2 to 1 | 4.4 to 1 |

The transaction will also add a significant amount of goodwill to our balance sheet. This will be amortized over 20 years so we will have an additional non-cash annual amortization charge. Goodwill on any balance sheet should be viewed with caution and only future results can truly validate its real value. We believe the premium volume, investments, business relationships and experienced staff will more than justify the goodwill.

Since the transaction was announced in August, we have been working very closely with the Terra Nova organization to make the transition as seamless as possible. In most respects we share similar values and as a result we believe the transition will be smooth. The Markel Style and our "Commitment to Success" is being shared throughout the Terra Nova organization.

## Expanding the Board and Management Team

The acquisition also gives us the opportunity to strengthen our Board of Directors and our management team. We are particularly pleased that Nigel Rogers, Jack Byrne and Mark Byrne will be joining our Board of Directors. Nigel Rogers has been President and Chief Executive Officer of Terra Nova since May 1998 and has been working in the London insurance market for over 20 years. Nigel will continue to run our international operations following the transaction. Jack Byrne is a director and large shareholder of Terra Nova. He is also Chairman and Chief Executive Officer of White Mountains Insurance Group, a Bermuda-based reinsurance holding company. Jack has enjoyed a long and illustrious career in the insurance industry having previously served as a senior executive of both Fireman's Fund and GEICO. Mark Byrne is Jack's son and is also a director and shareholder of Terra Nova. Mark is Chairman and President of West End Capital Management (Bermuda) Limited, a Bermuda-based investment management company. Mark was previously a Managing Director, Global Fixed Income Arbitrage, for Credit Suisse First Boston.

One of our strengths is that we have an experienced, talented and motivated staff. An unexpected benefit of acquiring Terra Nova is that it has created new opportunities for our associates. With our expanding organization we promoted Paul Springman to President of our North American operations. Paul previously served as President and Chief Operating Officer of one of our largest operating units, Shand/Evanston. Paul has over 20 years of experience in the insurance industry and is a past President of the National Association of Professional Surplus Lines Offices (NAPSLO). We are confident that Paul will help us continue to meet our performance objectives in our U.S. operations. Another change made possible by the acquisition is the transfer of Jeremy Cooke to Chief Operating Officer of Terra Nova in London. Jeremy previously served as President and Chief Executive Officer of our Investors

Insurance Group. Jeremy began his career at Lloyd's over 25 years ago, then founded and built his own brokerage business which he sold in 1986. Jeremy is also a past President of NAPSLO. We are extremely pleased that Jeremy will be working with Nigel and his team in London.

We are proud of the depth of the team we have built and our bench strength.

## Quality Balance Sheet and Loss Reserves

We have often stated that maintaining a quality balance sheet with a strong loss reserve position is a fundamental principle of our Company. In the past year many insurance companies had to fix balance sheet problems and acknowledge their corresponding underwriting problems. Our approach is to seek to maintain a high degree of confidence in the quality of our loss reserve provisions and to do so without being influenced by the desire to achieve short-term earnings goals. We continue to believe that our strong balance sheet means more than our quarterly earnings statement.

This philosophy, coupled with our disciplined underwriting standards, puts us in a position to take advantage of volatility and market opportunities. Many others today are suffering from poor underwriting and in many cases, worse accounting. The economic reality created by these events is now manifesting itself. Our discipline, both in underwriting and in managing our balance sheet, is creating real business opportunities and value for our shareholders.

## Acceptance Business

In late December we were able to reach an agreement with Acceptance Insurance Companies to purchase the renewal rights to their excess and surplus business produced from their Scottsdale office. As a result we formed Markel Southwest Underwriters and staffed it with former associates of Acceptance. The business we retain will be priced and underwritten to our standards.

In this transaction we are assuming none of the existing business. We will administer the runoff on behalf of Acceptance and may offer renewals in one of our companies based on our underwriting and pricing guidelines. Our goal is to manage this process to achieve an underwriting profit. We will be administering the runoff of approximately $100 million and expect to walk away from half or more of this business. As Paul Springman wrote to our new associates, "We fully expect that premium volume (at Markel Southwest) will fall this year, and will fall significantly! That's not only expected, it's OK! When we look at our numbers at the end of this year, the only meaningful barometer will

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be the combined ratio, not the top line. No one should be concerned about market share. Our focus needs to be on underwriting profits."

Paul's comments are a good example of our culture of focusing on underwriting results. This philosophy extends throughout our organization and is a major reason for our success.

## Trends in the Market

Beginning late in 1999 and continuing into this year we are seeing many more opportunities to write business on our terms and conditions. There are many examples of areas where companies are exiting classes of business that have proven to be difficult to write profitably. Additionally, many are looking to get rate increases. While it is far too early to call this a change in the market cycle, it represents the first time in many years that the insurance market environment showed any signs of improvement. There remains too much capacity in the industry, however, it is clear that the industry's return on this capital has been dismal. Maybe the time is coming when the industry will run its affairs to earn reasonable returns.

We believe we have the people, the capital, and the business culture to respond quickly and efficiently to opportunities in the market.

## Markel Associates

As we enjoy the success of the past and look forward to our bright future, we are especially thankful for the hard work and zealous pursuit of excellence demonstrated by our 883 associates, nearly all of whom are also shareholders. Our greatest pleasure stems from the fact that we are building an outstanding organization. Our results depend on each associate making important contributions and achieving individual goals every day. These individuals working as a team make our success possible. They share a vision and a passion for what our Company represents and we are confident that they will help us continue that success into the future.

On behalf of all our associates, we appreciate our shareholder partners, whose long-term confidence and support helps us achieve our goals.

Alan I. Kirshner

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel

Anthony F. Markel
*President and Chief Operating Officer*

Steven A. Markel
*Vice Chairman*

Darrell D. Martin
*Executive Vice President and Chief Financial Officer*

*From left to right: Anthony F. Markel, Darrell D. Martin, Steven A. Markel, Alan I. Kirshner*

MARKEL

# TO OUR BUSINESS PARTNERS

As our long-term shareholders know, Markel builds shareholder value through superior underwriting and investing results. Our success is measured by our compound annual growth in book value per share over the long term. For the past ten years, we compounded book value per share at a 23% rate; for the past five at 16%; and in 2000 book value per share grew 19%, excluding the effects of the Terra Nova acquisition. But read on to get the full story. 2000 was an event-filled year. We continued to demonstrate our superior underwriting ability in our North American operations; we completed the acquisition of Terra Nova and made significant progress in reorganizing this business into our Markel International operation; and we delivered truly exceptional investment results in a very difficult market. Both underwriting losses of discontinued lines and the newly acquired Markel International business negatively impacted operating results. In total, we reported a net loss of $28 million. Comprehensive income was a positive $81 million, which included unrealized investment gains. Shareholders' equity advanced from $383 million to $752 million or $68.59 per share to $102.63 per share.

Throughout the year we enjoyed improved market conditions in virtually all of our domestic business units. The property and casualty insurance industry suffered from intense competition for many years, leading to poor results and several company failures. The market has now changed and most competitors are exhibiting underwriting discipline or are out of business. We are getting many more opportunities to sell our products, prices are on the rise, and our results are beginning to reflect these improved conditions.

## 2000 Financial Review

Revenues for the year more than doubled and now exceed $1 billion. The acquisition of Markel International accounted for most of this growth; however, our North American business also enjoyed solid, profitable growth.

In total, earned premiums increased from $437 million to $939 million and we reported a combined ratio of 114%. This

2000

was the result of excellent performance of 97% from our North American operations, a disappointing 116% from continuing International business, and discontinued lines of 174%. In dollar terms our underwriting loss was $132 million, with North America contributing $16 million in profits, International a loss of $55 million and discontinued a loss of $93 million. We are working diligently to improve these results as quickly as possible to return to our historic standard of underwriting profitability. And we are optimistic that we will be able to do so.

Net investment income increased from $88 million to $154 million primarily due to the growth in the investment portfolio associated with the acquisition of Markel International. Approximately $1.5 million was earned from realized investment gains during the year, also a very significant $109 million was added in unrealized gains, net of tax.

As a result of the acquisition of Markel International, interest expense increased to $52 million and the amortization of intangible assets increased to $23 million. We reported a net loss of $28 million as compared to net income last year of $41 million. With the increased value of our investment portfolio, comprehensive income was $81 million compared to a comprehensive loss in 1999 of $40 million. Shareholders' equity increased to $752 million or $102.63 per share.

## North American Operations

Our core North American underwriting business units enjoyed a very successful year. Gross written premiums increased 27% to $711 million as the domestic insurance market continued to tighten throughout the year. The momentum grew exponentially, as fourth quarter gross written premiums grew 35% from substantial increases in submission activity, more new business and increased prices. Earned premiums increased by 18% with a combined ratio of 97%.

Every division in the North American group participated in the improved market, with our Excess and Surplus Lines companies seeing the greatest upswing. In early 2000 we opened new facilities in Scottsdale, Arizona named Markel Southwest Underwriters. This business came from acquiring the renewal rights of approximately $100 million in premiums from Acceptance Insurance Companies, Inc. We were up and running at the end of March, and we wrote $28 million in premiums for the year and expect to write approximately $50 million in 2001. Our Brokered E&S unit experienced underwriting problems during the year, primarily as the result of providing insurance for New York contractors. This class of business became very difficult to insure profitably and consequently we withdrew from the class. The experience was expensive but is now behind us. This division is now achieving significant price increases and we expect a profitable year in 2001.

The other North American operations performed extraordinarily well. Having a 97% combined ratio, coupled with an increase in gross written premium of 27% after a fifteen-year soft insurance market, is a real tribute to our associates. Our underwriting units are filled with skilled and dedicated associates focused on our mission of underwriting profitability, and we are thrilled with these outstanding results.

## International Operations

In March 2000 we completed the acquisition of Terra Nova (Bermuda) Holdings Ltd. We acquired this company to gain access to specialty, international insurance markets. We saw an opportunity to acquire a large specialty business, in many cases similar to our North American operations, which has the potential to earn underwriting profits. Additionally, Terra Nova enjoyed significant investment leverage. In acquiring this business, we recognized that a significant amount of work was necessary to reorganize the company, discontinue several unprofitable programs, and to reunderwrite its book of business. We were aware that during this process the business would not be profitable.

While more work needs to be done and our financial results do not yet show the magnitude of our efforts, we have made significant progress. We consolidated Markel International's operations into five business units from 11, and we reduced expenses accordingly. The Markel Style is being implemented with our focus on underwriting profits and incentive plans tied to performance. We centralized all accounting, investment, treasury and actuarial functions. We also consolidated all of our London operations from six unconnected offices to one well-located facility (two blocks from Lloyd's).

The underwriting results of our International operation were disappointing, as we had a combined ratio of 116% from continuing operations. This is approximately 6% worse than our original expectation. These poor results were due to business that was on the books prior to our acquisition. Throughout the year we repriced and reunderwrote the ongoing business, and eliminated many underperforming programs. As a result, we expect to report improved results in 2001, and we continue to believe that we will be able to achieve underwriting profitability in the not too distant future.

Over the years, Markel grew from both internal growth and acquisitions. While acquisitions always bring with them some surprises and integration difficulties, we are pleased with our track record. In fact, the longer our acquisitions have been part of the Markel family, the better they perform. We think that this speaks volumes about our culture and the underlying values of underwriting profitability, balance sheet conservatism, and long-term ownership that create a wonderful business.

## Discontinued Lines

Earned premiums from discontinued lines acquired with Markel International amounted to $120 million. The combined ratio on this business was 143%. These lines included unprofitable products where we did not believe we had a good opportunity to build a going-forward, profitable, specialty franchise. The business was commodity oriented, poorly priced, or underwritten without appropriate controls, knowledge and expertise. Additionally, during the third quarter we took a $32 million charge related to discontinued Gryphon programs.

At December 31, 2000, the remaining unearned premium on discontinued lines amounted to $65 million and while not expected to be profitable, should not cause material losses.

We have always prided ourselves on maintaining loss reserves which prove to be more likely redundant than deficient. This is certainly true with our North American businesses, where we have applied consistent underwriting and claims handling processes and have closely monitored loss development. In the context of an acquisition, where the underwriting and claims handling processes may have been inconsistent and several lines have been discontinued, it is almost impossible to establish the same margin of safety with loss reserves. While we believe the reserves of our recently acquired International operations are adequate, future adverse development is possible. As we reunderwrite and apply strong and consistent standards to our International business, we expect to develop the same confidence with its loss reserves.

## Investments

Achieving superior investment returns has long been an integral component of our philosophy, and a strong contributor to our long-term growth in book value. The purchase of Markel International added over $1.4 billion to our investment portfolio and the investment environment in 2000 was one in which we excelled.

During 2000, the white-hot and psychologically-driven NASDAQ market imploded with a loss of almost 39%. The Dow and S&P indices also declined 6% and 10% respectively. We were never able to understand the valuations of many of the most popular stocks of 1998 and 1999, and as a consequence avoided investment commitments to that area. We were rewarded this past year as our focus on intrinsic business values provided us with an equity return of 26% during a time of difficult results in the broader markets. In our equity investing, we remain focused on reasonably priced profitable companies, with honest and talented management and capital discipline. Over the years this focus served us well and it will remain the litmus test for how we consider equity investments in the future.

In the fixed income markets, we remain committed to a high quality portfolio with maturities similar to those of our insurance liabilities. We wish to earn a positive spread on our policyholder funds without taking unwise credit or interest rate risks. This foundation, along with profitable underwriting activities and a conservative balance sheet, allows us to allocate the bulk of our shareholders' equity to the equity markets and earn a higher, though usually more volatile, return over time.

## Stock Offering

In February 2001, we completed the sale of additional shares of common stock and raised almost $200 million in new capital. While we were reluctant to issue new shares and dilute the interest of our existing shareholders, we believe that the additional capital will generate excellent returns both for our existing shareholders and for our new business partners.

With the acquisition of Markel International, we increased our financial leverage such that our debt to capital ratio increased to 39%. Our long-term target is one-third debt, two-thirds equity. With the new equity, our debt to capital ratio will be below our long-term leverage target. We believe that putting our balance sheet in a strong, conservative posture will enable us to take full advantage of our tremendous opportunities.

We are particularly pleased that a number of our existing shareholders added to their holdings, and that a number of old friends joined us as new shareholders. One of our strengths is that our long-term shareholders understand our business philosophy and support it. We think the same is true of our new shareholders.

## Market Trends

In early 2000, we saw a cyclical change in the property and casualty insurance market, with prices going up and more opportunities for us to write profitable business. As the large, standard, commodity oriented companies seek to improve their results, they become more selective in their underwriting, and increase prices. As a result, more and more business moves into the specialty insurance market. As a leader in the specialty market, Markel is well positioned and prepared to take advantage of this change. As the year progressed the market continued to harden. Our North American premium volume increased progressively throughout the year with a 33% increase in the third quarter, and a 35% increase in the fourth. These increases were the result of both new business opportunities and higher prices. This trend continues in early 2001.

It has been almost fifteen years since we experienced a truly "hard" insurance market. During that period, financial results throughout the industry were poor, many companies failed, and the industry consolidated. At long last underwriting discipline is returning and prices are going up. The question on everyone's mind is "how long will this last?" Unfortunately we don't know. What we do know, however, is that the problems created over many years will not be solved quickly. It is certainly time for the cycle to move in our direction and we will take full advantage of this opportunity.

## Directors

Jack Byrne advised us that he would not be standing for re-election at our next shareholders' meeting. His personal commitment to White Mountains Insurance Group and its planned acquisition of the CGU Insurance Group prohibit him from continuing on our Board. We appreciate Jack's contribution to Markel and know his advice will still be available.

At our last Board meeting, Doug Eby joined the Board. Doug is President of Robert E. Torray & Co., an independent investment firm with over $6 billion under management. Doug has been an investment manager for over 15 years and is very active as a volunteer in his community. The Torray organization is also our largest outside shareholder. We know Doug will make a valuable contribution to our Company.

## Markel Associates

With the addition of Markel International and our continued growth in North America, we have over 1,500 associates in the Company. Our success has always been our ability to build a team of people with the shared values of The Markel Style. Markel enjoys a strong culture and underlying value system that defines our Commitment to Success. Everyone here knows the importance of, and is committed to, producing an underwriting profit, maintaining a strong, conservatively-stated balance sheet and honest and fair accounting. Each associate has the opportunity to achieve his or her goals, yet work as part of our team. We have a respect for authority, but disdain of bureaucracy. We repeat this message endlessly inside our organization to reinforce the beliefs with our long-term associates as well as to pass the message on to our newer associates. These soft and intangible assets are what ultimately produce the hard and tangible results that we have delivered in the past, and expect in the future.

We welcome our newest associates and look forward to our mutual success. We thank all of our associates for their hard work throughout the past year and for their Commitment to Success.

And we thank you, our shareholders, for your support.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

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*President and Chief Operating Officer*

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*Vice Chairman*

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MARKEL

# TO OUR BUSINESS PARTNERS

The events of September 11th overshadow everything else that occurred during the year. The terrorist attacks on the World Trade Center and the Pentagon changed the world and impacted all of us. While the losses in human life and economic terms are substantial, we are thankful that so many people were able to escape safely. We also believe our society will work towards building a stronger and safer world. Financially, we will recover from these losses.

Unfortunately, the losses associated with the terrorist attacks were not the only surprises we faced in 2001. In addition to $75 million in losses from the World Trade Center events, we recognized an additional $29 million in adverse loss development from one of our North American programs and took charges of $109 million in our international business. Without question, 2001 was a difficult and disappointing year.

Throughout our 72-year history we built an organization with a record of conservative accounting and reserving methodologies as well as enviable underwriting profits. Our goals and philosophy have not changed, but we clearly failed to deliver in 2001.

Fortunately amid the disappointments, 2001 did include many positive developments. We are now well prepared to deliver the quality results that you and we have come to expect. It feels like we have been in the London market for an eternity, but in truth it has been less than two years. Throughout the year we continually worked to integrate the operations of the international business we acquired in March of 2000. While we recognized significant losses, we believe we made substantial progress. Additionally, the current market environment is without question, the best we've seen in many years. We are currently enjoying significant, well-priced growth in our business across almost all lines. We are exceptionally proud of our investment operations, which generated fantastic returns. While we will always emphasize the importance of great underwriting, our investment operations are also a critical element in our objective to compound book value per share at high rates of return over time.

We measure our financial success by compound growth in book value per share over the long term. For the past ten years we compounded book value per share at a 22% rate and for the past five at 18%. Excluding the effects of the issuance of new common stock, 2001 book value per share declined 10%. As a result of the additional capital raised during the year, book value per share increased from $102.63 to $110.50 and total shareholders' equity advanced from $752 million to $1.1 billion.

2001

## 2001 Financial Review

Revenues increased 28% from $1.1 billion to $1.4 billion with a full year of international operations along with accelerating growth in North America. Earned premiums were $1.2 billion and our combined ratio was 124%. North American operations reported a combined ratio of 102%, which includes the $29 million charge for the discontinued New York contractors program. Adjusted for this, the North American combined ratio would have been 97%. Markel International reported a combined ratio of 134%. Excluding the unusual events, and the reserve strengthening of Terra Nova's pre-Markel reserves, it would have been 113%. Finally, discontinued lines reported a whopping combined ratio of 229% bringing total underwriting losses to $294 million.

Clearly these are disappointing and unacceptable results. We are upset not only at the magnitude of the losses we incurred, but also at the need to increase reserves. For years we built a record based on conservative reserving methodologies and we are justifiably proud of our history. Going forward you can rest assured of several things. One, as we have demonstrated, we will not hesitate to take the painful but necessary steps to recognize reserve deficiencies if they arise. Two, we have worked, and will continue to work diligently to improve the ongoing operations at our international business. And three, we remain committed to conservative accounting and reserving practices. All of these actions should act to rebuild our record of achievement over the next several years.

Finally, we think it worth mentioning that Markel has a demonstrated record of improving on our acquisitions as time goes by. All of our purchases have been of companies from the "scratch and dent sale" with less than wonderful financial performance. Those were the only sorts of companies that were reasonably priced during our process of building a small insurance broker into an industry leading specialty underwriting organization. While Terra Nova is a bigger challenge than our previous purchases, we are optimistic that our culture and our discipline will ultimately work as well in London as it has in every other circumstance.

Our equity investment portfolio earned a total return of 16.9% during 2001. This was a fabulous result in what was a difficult environment for most investors. Our focus on disciplined, common sense investing has served us well for many years now. Reported net investment income increased from $154 million to $171 million despite lower interest rates with the addition of the Markel International portfolio for the full year. Realized gains amounted to $20 million and unrealized gains increased by $76 million for the year. The total return on our investing activities was 8.4%, an excellent result in a tough year.

After interest expense, amortization of goodwill, and tax benefits, we reported a net loss of $125.7 million as compared to a net loss last year of $27.6 million. After the increase in the value of our investment portfolio, we reported a comprehensive loss of $77 million or $9.01 per share.

During 2001, total investments and cash increased from $3.1 billion to $3.6 billion and long-term debt and convertible notes payable decreased from $573 million to $381 million. During the year we also issued 2.5 million common shares raising $408 million in new equity to strengthen our financial position.

At year-end total shareholders' equity was $1.1 billion or $110.50 per share as compared to $752 million or $102.63 per share the prior year.

## North American Operations

Our North American operations enjoyed a strong year as the longstanding skills of our talented underwriters began to be aided by a tailwind of specialty insurance-marketplace improvement. Gross written premiums reached the $1 billion milestone, which represented a 41% increase over last year. This improvement accelerated throughout the year and in the fourth quarter, premium volume increased 54%.

Earned premiums for the year were $642 million, an increase of 36%. The combined ratio was 102% as a result of the $29 million adverse loss development from the New York contractors program that was discontinued in January 2000. We thought we had adequately dealt with this problem last year when we wrote, "the experience was expensive but is now behind us." Despite the fact that we always seek to identify problems quickly and establish conservative loss reserves, we are not always able to succeed. This charge added 5% to Markel North America's 2001 combined ratio.

Our other Excess and Surplus Lines operations enjoyed very good underwriting results with both the Essex E&S unit and the Professional/Products Liability unit delivering great performance. The Markel Southwest operation completed its second year of operation very close to its budget and is expected to be contributing underwriting profits in the near future.

Our Specialty Admitted operations finished the year with a combined ratio of 101%. The Specialty Program business at Markel Insurance Company generated underwriting profits while the Specialty Personal business at Markel American Insurance Company reported modest underwriting losses in its property and high performance watercraft products.

Over the years, we have become a leader in the specialty property and casualty business in North America. We have the people, products, relationships and financial strength to take advantage of the current market opportunities. Throughout the past year we enjoyed both price and volume increases which have continued into 2002. The market has turned after many years of cutthroat competition and significant underwriting losses. We expect to apply our knowledge, skill, and underwriting discipline to achieve profitable growth in this marketplace. Our underwriters produced wonderful results for 15 years during progressively softer and softer insurance markets. We think that you can understand why we are optimistic about our future now that the marketplace is firming.

## International Operations

Markel International finished the year with gross written premiums of $716 million, earned premiums of $468 million and a combined ratio of 134%. The World Trade Center loss was the single biggest factor. We continue to monitor claims from this event and currently believe that our original loss estimates are sound. In addition, the International operation took a fourth quarter charge in the amount of $20 million to provide for the significantly higher costs to renew marine and energy reinsurance treaties into 2002. Excluding these charges the combined ratio was 113%, which remains unacceptable.

We have accomplished a great deal toward improving our international business. Most importantly, we focused the business on six products where we believe we have, and can further develop, the specialty focus needed to earn consistent underwriting profits. This process unfortunately required the departure of an unexpectedly high number of employees. Some left because they did not like our culture or think they could achieve our admittedly challenging objectives. Others, because we did not think they could adapt. Although this is a difficult and arduous process, we have been through this before with previous acquisitions. We think we made good progress in building the Markel Style in London. We believe that we have a team in place to achieve success. We are committed to earning underwriting profits and are taking the necessary actions to achieve this goal.

Our ongoing international underwriting units are Aviation, Marine and Energy, Non-Marine Property, Professional Liability, Retail Professional Liability and Reinsurance and Accident. In addition, we have service companies in the United Kingdom and Australia that sell several of our product offerings. We are seeing significant improvement in the market conditions and as a result we are now enjoying price increases which will help drive future underwriting profit.

Operationally, we have two underwriting entities, Terra Nova Insurance Company (a London Market insurance company), and Markel Syndicate 3000 (a Lloyd's of London syndicate). We write about 75% of our international business through our wholly-owned Lloyd's syndicates. While we are excited to be part of Lloyd's and believe it has the opportunity to continue, and enhance, its pre-eminence in the world's insurance marketplace, we also believe that the market must make changes. Some of the changes we recommend include: the end of the annual venture and three-year "reinsurance to close" process; ending inappropriate use of reinsurance leverage and structure; not writing multi-year policies without concurrent reinsurance protection; correcting poorly managed delegated authorities; improving slow policy services and reducing costs; and improved governance, regulation and accounting. Over the past 300 years Lloyd's has built a valuable franchise. Unless it improves its business practices its value could be seriously diminished. We have dealt with these issues within our business and we support Lloyd's reform efforts because a stronger Lloyd's will enhance Markel's opportunities.

## Discontinued Lines

Discontinued lines include the run off business from Gryphon Insurance, from discontinued programs at Markel International, and from the reinsurance business at Corifrance, an ongoing operation being held for sale. Gross written premiums from discontinued lines were $54 million with earned premiums of $97 million. Underwriting losses were $125 million or a 229% combined ratio. The major reasons for this loss were the charges for the discontinued motor business ($39 million), increased reserves for asbestos losses ($20 million) and additional reserves for reinsurance collection issues ($25 million). We never expected that the cost of these programs would be as high as they have been. We are continuing to work diligently to manage these exposures as efficiently and effectively as possible and to adequately reserve for all future costs.

## Investments

Our approach to investing is an important element of our goal of compounding book value per share over the long term. We believe that sound investing is a critical part of our long-term success and our results in this area clearly distinguish us from most insurance companies. In 2001 we achieved exceptional results in a very difficult investment environment. Our equity returns were 16.9% for the year as compared to a loss of 11.78% for the S&P 500 Index. Our fixed income returns were also favorable as we maintained a high quality portfolio and avoided losses suffered by more adventuresome fixed income investors. Total investment returns for the year were 8.4%.

Our investment results over the past 10 years are shown in the following chart.

| | One Year | Five Years | Ten Years |
|---|---|---|---|
| Markel Total Return | | | |
| Fixed maturities | 7.70% | 7.50% | 7.50% |
| Equity securities | 16.90% | 15.40% | 16.40% |
| Market Indices | | | |
| Lehman Aggregate Index | 8.44% | 7.43% | 7.23% |
| S&P 500 Index | (11.78)% | 10.70% | 12.10% |
| Value Added by Outperformance | | | |
| Fixed maturities | (0.74)% | 0.07% | 0.27% |
| Equity securities | 28.68% | 4.70% | 4.30% |

Our first objective in managing our investment portfolio is to be certain that we can meet our obligations to our policyholders. As a result, policyholder funds are invested in high quality fixed income securities with a similar duration profile as that of our insurance liabilities. Shareholder funds are predominately invested in common stocks where, with sound management, we can earn significantly greater total returns over the long term. We have added value both by outperforming relative benchmarks and by increasing our long term allocation to equity securities. Our total equity returns over the past 10 years averaged 16.40% as compared to the fixed income returns of 7.50%. This additional return on the assets we've allocated to equities has added substantial value to Markel. At year-end we have allocated $544 million to our equity investments and expect this to increase in the future.

We believe we have achieved these results because we have adopted a sound, common sense investment approach. We buy what we believe to be reasonably priced, profitable companies, run by honest and talented management with capital discipline. We want to find companies that we can own for the long term, both to minimize transaction costs and taxes. As a result, our turnover is very low and we've accumulated large unrealized gains in the portfolio.

We are optimistic that equity markets will continue to provide us with opportunities to build shareholder value over time. The volatility that occurs on a regular basis has and should continue to be more of an opportunity than a hindrance in our quest to earn solid investment returns.

## Capital Raising

It was a busy year for us in the capital markets. We issued 2.5 million new shares raising $408 million in additional capital. Approximately $245 million of the proceeds were used to reduce our debt. Additionally, we issued a zero coupon convertible note with a 4.25% yield to maturity to repay an additional $100 million. As a result of these transactions, we enjoy a strong financial position. Our ratio of debt to total capital improved to 24% as compared to 39% last year. Despite this balance sheet strength, our ratings with various credit rating agencies are not as strong as our balance sheet alone would support. This is due to our losses, the majority of which were charges reported as the recognition of reserve deficiencies at Markel International from prior to our acquisition. We expect meaningful operating improvements in the future, and as this occurs, our ratings should be stronger.

## Director

Mark Byrne has advised us that he will not be standing for re-election at our next shareholders' meeting. Mark feels his personal and business commitments prevent him from continuing on our Board. We will miss Mark's advice but thank him for his contributions and support.

## Closing Comments

Clearly 2001 was a difficult and disappointing year at Markel. We do not like reporting reserve deficiencies and unusual charges as many other insurance companies did in 2001. While the vast majority of these charges relate to the integration of the Terra Nova acquisition, and should be behind us, we remain embarrassed by these results. In the past we've prided ourselves on our proven track record of being different, and better, than other insurance companies.

We remain optimistic because the things we did differently than the insurance industry at large to build our record of accomplishment remain unchanged. Markel is built upon the consistent values of integrity, long term focus, and conservative accounting. These will never change. Fortunately, the people who make up this organization seem to get better at their jobs the longer they are part of this culture. We are confident that this will be true for our London based colleagues as well and we look forward to earning your continued support.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

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*President and Chief Operating Officer*

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*Vice Chairman*

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*Executive Vice President and Chief Financial Officer*

*From left to right: Alan I. Kirshner, Anthony F. Markel, Darrell D. Martin, Steven A. Markel*

2002

# TO OUR BUSINESS PARTNERS

Your company is building a premier, specialty, property and casualty insurance organization focused on consistent underwriting profits, superior investment returns and building shareholder value. We're building an organization with a strong corporate culture and sound values, The Markel Style. And it's being built to last.

During the past few years the property and casualty insurance industry experienced the perfect storm. Your company endured these troubled waters and in the same period reorganized and restructured our international acquisition. In this period, we faced challenges larger than expected and our results were less than we would like. In spite of these events, we continued to build the value of your company. And, more importantly, we are positioned to continue to deliver results and achieve our goals.

Net income for the year was $75 million. That's a record. We never thought we'd be disappointed in earning $75 million. But given our capital base our return on equity is below our target and net income per share of $7.65 is below our results in 1996 to 1998. We can and will do better.

Yet in 2002 the good news far outweighs the bad. The North American operations are solid and capitalizing on an ideal insurance environment, our International business is showing solid and continuous progress and our investment activities are performing exceptionally well in a difficult environment. We are positioned to achieve our financial goal of compounding book value per share at a high rate over the long term.

## THE PERFECT STORM

The insurance industry sailed through the decade of the nineties on a wave of strong investment returns. Declining interest rates resulted in increasing bond values. At the same

MARKEL

time rising stock prices encouraged equity investing. The result was a soft and very competitive insurance environment typified by lower prices and a loss of underwriting discipline. Insurance companies chased unwise growth but sloppy underwriting and poor pricing were offset with good investment returns. When that was not enough, insurance companies structured transactions that traded future investment income for current benefit to mask the real results, or simply took too optimistic a view when establishing loss reserves.

This environment obviously could not last. During the past three years, the industry experienced a series of events causing substantial losses and shaking its very foundations.

Just as environmental losses associated with toxic waste sites were being resolved, another problem exploded—asbestos. Total costs are estimated to approximate $200 billion and the industry is thought to be $20 billion to $40 billion under-reserved. In the past two years, 22 companies declared bankruptcy and over 600,000 individuals (many people who are not currently sick) are seeking benefits.

Additionally, in many states lawyers and juries turned medical malpractice claims into the newest lottery. Companies specializing in this business left the market, went broke, or sought triple digit price increases. Doctors in West Virginia, New Jersey and Pennsylvania threatened to strike.

Of course, the claims issues were just part of the problem. Investments also turned sour. Just as equity investing looked like easy money, insurance companies increased their allocations only to catch the bubble at its peak. Since its high in early 2000, insurance companies have lost billions in stock market investments.

And today, investment yields are too low to cover bad underwriting results, much less provide a meaningful return on capital for most companies.

The terrorist attack on September 11th not only shocked the world but also proved that unimaginable events could actually happen. While not comparable to the human loss, the insurance industry suffered economic damages estimated to be $40 billion to $50 billion.

Finally, the industry also participated in losses from the Enron/Tyco/Worldcom corporate governance crisis. Property and casualty companies owned the securities; they wrote the Directors and Officers insurance coverage; and those most creative, joined with banks to provide surety bonds and poorly conceived financial guarantees. Each and every misstep caused billions in losses.

All of this created the perfect storm.

While Markel did not avoid all of these problems, we missed most of them.

Throughout the nineties we avoided the extremes of the competitive insurance market, and instead grew through acquisition. Of course, many of the companies we acquired had problems as a result of their participating in this difficult market. Buying troubled companies and fixing them has been our growth strategy. And it's been effective. Virtually all of the acquisitions we completed continue to get better with age.

On the underwriting side, we've continued our focus on specialty products where we can earn consistent underwriting profits.

On the investing side, we've maintained our equity focus by buying into sound businesses, run by honest and talented managers with capital discipline, all at reasonable prices. Our fixed income investments concentrate on high quality securities, selected thoughtfully, one by one from the bottom up. Sticking to this philosophy prevented us from experiencing the investment mistakes made by so many others.

We now look forward to greater success in the aftermath of this perfect storm. Demand for insurance coverage is up, supply is down, and prices are very favorable. We are financially strong and able to take advantage of our current opportunities. More importantly, we have a strong and talented group of professional insurance underwriters who understand how to price and manage risk. Our team of disciplined and experienced people represents our intellectual capital. This intellectual capital, infused with our corporate culture over many years, is our real strength.

## 2002 FINANCIAL REVIEW

Revenues increased 27% from $1.4 billion to $1.8 billion primarily as the result of the accelerating growth of business in our North American markets where our specialty insurance business enjoyed both price and volume increases. Earned premiums were up 28% to $1.5 billion and our combined ratio was reduced to 103%. While still not at the desired level of underwriting profit, we did achieve this goal in the fourth quarter with a combined ratio of 99%. For the year our North American operations had a combined ratio of 94% and International reported a combined ratio of 107%. International results improved each quarter as earned premiums from business properly priced and underwritten flowed through our financial statements. This trend is encouraging. Discontinued business and developments from our exposure to asbestos claims added $69 million in underwriting losses. This is obviously disappointing and we are doing everything we can to avoid the repetition of these events.

Total investment return for the year was a quite acceptable 8.3%. Equities were down 8.8% and fixed income securities were up 9.8%. While it's tough to be happy with negative stock returns, we out-performed the major indexes by a wide margin and we remain confident in our investing philosophy. Investment income was flat with last year at $170 million as lower yields offset the growth in the size of our portfolio. We realized $51 million in gains from the sale of securities as we repositioned segments of our investment portfolio. Unrealized gains increased by $5 million as the impact of lower interest rates increased the value of our fixed income securities more than declining stock values hurt our equity portfolio. Foreign currency adjustments had an adverse effect of $7 million.

Net income in 2002 was $75 million and comprehensive income was $73 million as compared to large losses last year.

During 2002 total investments and cash increased to $4.3 billion from $3.6 billion a year ago. This is a $723 million increase or 20%. On a per share basis, cash and investments at year-end amounted to $439 as compared to $366 last year. [In accordance with new SEC rules, this data is no longer included on pages 30 and 31 of our annual report. However we feel that this information is useful in the evaluation of our company.]

After a busy year in the capital markets in 2001, we were very quiet in 2002. We borrowed $140 million under our bank facility to repurchase $35 million of our short term convertible notes and to provide adequate capital to our businesses for their 2003 plans.

Shareholders' equity increased to $1.2 billion. Year-end book value was $118 per share, up only 6.7% from last year. In the past 5 years we have compounded book value per share annually by 13% and in the past 10 years by 19% (including the effect of stock issuances).

## NORTH AMERICAN OPERATIONS

In 2001 gross written premiums reached the $1 billion mark, an increase of 41%, and a milestone for our North American operations. The specialty market turned after a long period of cutthroat competition. While we knew the outlook for 2002 was bright, we did not expect to see the 55% growth to $1.6 billion that we achieved. We are convinced that growth will continue at a very good rate for the foreseeable future, but not at the extraordinary rates seen in the recent past.

Earned premiums for the year were $1 billion up 49% from last year. Most importantly, the combined ratio declined from 102% in 2001 to 94% in 2002, as the increased volume helped reduce the expense ratio and improved prices reduced the loss ratio. In the current environment, we expect our underwriting profit to grow.

Our North American operations were not perfect, however. We experienced some further adverse loss development in our casualty business at our Brokered Excess and Surplus Lines division and some underwriting problems with our property business in Markel Southwest. Our Specialty Admitted business achieved an underwriting breakeven. While this may have been acceptable in a higher interest rate environment that is no longer the case. To achieve our financial objectives in today's interest rate environment, we require a few points of underwriting profit.

The combination of growth and improved pricing led to exceptional results at our Essex Excess and Surplus Lines and Professional/Products Liability divisions. Throughout our North American operations, our talented and experienced underwriters responded to the needs of our clients by providing quality, specialty insurance solutions to their problems as standard insurance markets cancel and non-renew business that they find difficult to manage. We expect this environment to continue.

In the fourth quarter we announced that John Latham joined us to develop Markel Re. John possesses wonderful experience in the business, including a prior stint with us. As a past president of the National Association of Professional Surplus Lines Offices (NAPSLO), bringing John back to Markel means that we now have four past presidents of this leading industry association among our associates. Markel Re will focus on the excess casualty market both on a direct and a facultative reinsurance basis. We expect it to be up and running in the second quarter of 2003.

At year-end the Terrorism Risk Insurance Act became law. This law voided previously issued exclusions for terrorism and required companies to offer coverage for this exposure. The federal government became a reinsurer of the industry for 90% of claims in excess of $10 billion. While this act raises many problems and concerns, the insurance industry needs to learn to live with it. In compliance with this act, we have offered our clients terrorism coverage for a price and the option to accept a terrorism exclusion. We do not expect that many of our clients will choose to buy the coverage. However, as long as we can manage this risk and charge an appropriate premium, we are happy to provide the coverage.

## INTERNATIONAL OPERATIONS

Markel International completed the year with $622 million in gross written premiums, $559 million in net earned premiums and a combined ratio of 107%. These results represent significant progress from last year when we reported a combined ratio of 134%. Throughout the year we showed progressively improved results as business put on the books over the past two years has been more soundly underwritten and better priced. Starting in the first quarter the combined ratio was 110% and it improved to 107%, 106% and 104% in each successive quarter. While we are behind our original schedule, underwriting profits are on the horizon.

We originally entered the International market in March 2000 and in the past three years accomplished a great deal. We focused our business in several specialty product areas and offer our clients security in either Markel Syndicate 3000, our syndicate at Lloyd's of London, or Markel International Insurance Company Limited, which formerly operated as Terra Nova Insurance Company Limited. By putting the Markel brand on our London businesses, we are demonstrating our long-term commitment to this market as well as recognizing that this business has truly become an integral part of the Markel organization.

The market environment for our International business is very similar to the opportunities we face in North America. Underwriting discipline and improved pricing have returned to the market. We reduced our gross premiums as we restructured our business in 2002, but are now looking at opportunities to grow, develop and take advantage of more favorable market conditions in 2003.

## DISCONTINUED LINES

While significantly smaller than last year, we still had to absorb $69 million in underwriting losses from discontinued lines. Several items contributed to this loss; however, most significant was an increase in our reserves for losses associated with asbestos claims. For many years we built our claims models by looking at and trying to understand our total exposure by reviewing individual policies and claims from the bottom up. In the fourth quarter of 2001 we completed an in depth study of exposures from our International business and increased reserves as we thought appropriate. At the time we believed our North American reserves were adequate. During the past year, events worsened as more claims have been brought, particularly by non injured claimants. Also, more companies declared bankruptcy, negatively impacting our ability to defend asbestos claims. As a result, we increased reserves (mostly in North America) in the third quarter of 2002. While our asbestos exposure is both material and significant, our companies were not major insurers during the period when most exposure existed and as a result we are a minor player in the asbestos quagmire.

Corifrance is our French reinsurance company and its results are included in discontinued operations. The company has not been discontinued. Corifrance net earned premiums were $26 million in 2002 with very satisfactory results as the reinsurance market enjoyed improved pricing and fewer claims. The company's results are included in this category, as we hold the business as available for sale. We had and have no intention of giving the business away, and have obviously not yet sold it. Corifrance is a solid company and its management team is well disciplined in its focus on underwriting profitability.

## INVESTMENTS

We believe that sound investing is a critical part of our long-term success and our performance in this area clearly distinguishes us from most insurance companies. In 2002 we earned a total return of 8.3% on our investment portfolio. This is a very good result in a very difficult market. We lost 8.8% in our equity investments, which, while disappointing, is much better than the 22% loss in the S&P 500 Index. We do not manage against this index nor do we think in relative terms. Likewise, we do not expect equity returns to be smooth and always up. We do expect equities to provide good, long-term total return to our portfolio. Our fixed income securities provided a total return of 9.8%, which was in line with the comparable indexes. We avoided all of the credit problems of the technology, telecommunications and energy trading businesses of the past year as we have consistently focused on high quality credits assessed individually one at a time.

Our investment returns over the past 10 years can be seen in the following chart.

| | One Year | Five Years | Ten Years |
|---|---|---|---|
| Markel Total Return | | | |
| Fixed maturities | 9.80% | 8.00% | 8.00% |
| Equity securities | (8.80%) | 6.80% | 11.20% |
| Market Indices | | | |
| Lehman Aggregate Index | 10.26% | 7.55% | 7.51% |
| S&P 500 Index | (21.96%) | (0.15%) | 9.08% |

We have added significant value by following a sound investment discipline. We don't think of our investments as paper to trade, but rather as equity ownership of real businesses. Our success in investing is a direct result of the success of the businesses we own.

For the past few years we have had a lower than normal allocation to equities. This was due to several factors. Our portfolio doubled in size with the Markel International acquisition in 2000, we needed to focus on building the balance sheet as we absorbed losses related to this acquisition, and we had trouble finding great opportunities in equities as stock prices soared. At year-end our equity portfolio is $551 million and represents 13% of our total portfolio and 48% of total shareholders' equity. This remains lower than we would normally prefer as we think as much as 20% to 25% of the portfolio or 75% to 80% of shareholders' equity can reasonably be allocated to equity investments. While we have no need to rebalance immediately, we are increasing our allocation at a time when we believe we can find quality opportunities at favorable prices. We have no idea whether or not 2003 will prove to be the fourth consecutive year of substandard equity returns. We do believe that for those with a long-term time horizon, it's a great time to invest in American businesses.

We will always need to have a large part of our investment portfolio in fixed income securities in order to meet future claims liabilities as they come due. We are very mindful that with current interest rates being relatively low, we face the risk of declining value in fixed income securities should interest rates increase. This is a difficult risk to completely avoid, however, we will be cautious in the duration of our bonds thereby minimizing this exposure.

## BALANCE SHEET / CAPITAL ISSUES

Along with the strong growth in written premiums in 2002, we enjoyed a 20% increase in our total investments and cash to $4.3 billion. This increase totals $723 million and is the result of operating cash flow of $507 million, increased debt of $102 million that was used to provide capital to our insurance companies to support their future growth and foreign currency increases. At year-end investments and cash are 3.7 times as large as shareholders' equity as compared to 3.3 times a year before. This increase in investment leverage is important to our financial model.

Sound loss reserving is critical to our success. Our goal is to set reserves at a level believed to be more likely redundant than deficient. In 2002 there were several areas where we failed to achieve this goal. We increased reserves for asbestos, other discontinued business, as well as for casualty losses in our Brokered E&S division. In setting loss reserves we attempt to add a margin of safety on current year business reserves by discounting the impact of current price increases and looking cautiously at new business. Reserving is more art than science and no matter how diligent we are, is subject to unknowable future events. We believe our year-end reserve levels meet our goal.

We do not normally comment on unearned premium reserves, however, given the embedded equity included in these reserves we think it is appropriate to do so. At year-end gross unearned premiums were $937 million. Net unearned premiums were $718 million. These amounts will be earned over the next year. Given the recent price increases as well as our recent underwriting performance, we expect that barring any major earthquakes, hurricanes or other unusual events, future profits will be earned from this unearned premium.

At year-end shareholders' equity advanced to $1.2 billion or $118 per share. Growth for the year was only 6.7%. We need to do better and we will. As we demonstrate our operating strength with consistent underwriting profitability, we will grow our capital base at a faster pace.

In February 2003, we issued $200 million of ten year notes. Proceeds will be used to repay our bank debt and partially pre fund debt maturing later in the year. This issuance extended our debt maturities and enhanced our liquidity. We enjoy a strong financial position and we have enough capital to support our current business plans.

## CORPORATE GOVERNANCE

Corporate governance issues have become an important topic and one worthy of a few comments. Early in our days as a public company (and even before) we gave a great deal of thought to building, developing and maintaining good relationships with our shareholders. After all, our shareholders were family, friends, and neighbors as well as institutional investors.

For many years, Berkshire Hathaway has published in its annual report a list of "owner-related business principles." The first, and one that we have tried hard to duplicate, states, "Although our form is corporate, our attitude is partnership. [We] think of our shareholders as owner-partners... We do not view the company itself as the ultimate owner of our business assets but instead view the company as a conduit through which our shareholders own the assets." In a further discussion of this principle the report says, "[We] hope that you do not think of yourself as merely owning a piece of paper whose price wiggles around daily... We hope you instead visualize yourself as a part owner of a business that you expect to stay with indefinitely... For our part, we do not view Berkshire shareholders as faceless members of an ever-shifting crowd, but rather as co-venturers who have entrusted their funds to us..."

This principle, if followed, would eliminate any concern about corporate governance. Treat your shareholders like you would want to be treated if the roles were reversed. Of course, that's a lot easier for us because we are fortunate to have "share-owners" who are with us for the long term as opposed to "share-renters" who are just trying to catch a wave.

As a result of the recent abuses we now will be forced to live with new laws and regulations intended to improve corporate governance. Unfortunately, some will follow the letter of these new rules and do nothing to live up to the spirit behind them. Likewise, many of these requirements will add cost without any benefit and in some cases will undoubtedly make governance worse.

Fortunately, we have always met the spirit of sound corporate governance and we do not need to change our philosophy. We have always believed our shareholders should get their fair share of the business returns and not be exposed to any management "haircut." We decided not to issue dilutive stock options many years ago. Our bonus plans are logical and rational and correctly align our associates' performance with shareholder value. They are fair for both associates and shareholders. Our stock loan plan has enabled associates to acquire reasonable amounts of stock and pay for it over an appropriate term at attractive interest rates. We have not forgiven share loans. The plan is far more shareholder friendly than option plans. Unfortunately, your executive officers and directors will no longer be able to participate in these plans. It seems inconsistent that under the new rules option plans are allowed, yet loan plans are not. An option plan is the equivalent of an interest-free loan where the beneficiary can walk away from repaying the principal.

In our efforts to begin complying with both the spirit and the letter of new requirements, we are pleased to have added Jay Weinberg as an independent director to our board. Jay is Chairman of the Hirschler Fleischer law firm in Richmond, Virginia. For those of you from the Richmond area, you may already be aware of Jay's well deserved reputation for excellence and integrity. We believe he will add real value to our board and we are gratified he has agreed to join us.

We will continue to respect our shareholders and their capital. We recognize that it is our obligation to earn a fair return on that capital.

## THE FUTURE

Our company is truly in a unique position to benefit from the changes in the insurance world, as well as to capitalize on our investments over the past several years. Insurance prices are strong and look to stay that way for some time. Standard insurance markets continue to tighten their belts and send more business to specialty carriers. Our reserving and accounting practices reduce (not eliminate) the potential for unfortunate surprises. Our growing investment portfolio and strategy bode well for future prospects. We've built one of the best teams in the industry and have the intellectual capital necessary to compete successfully. And our shareholders know that they will get fair treatment.

We owe a huge thank you to all of the Markel associates who have helped make our dreams a reality and who we count on to continue our commitment to success. As always, we thank you, our shareholders, for your continued support.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*President and Chief Operating Officer*

Steven A. Markel
*Vice Chairman*

Darrell D. Martin
*Executive Vice President and Chief Financial Officer*

*From left to right: Alan I. Kirshner, Anthony F. Markel, Darrell D. Martin, Steven A. Markel*

# 2003 TO OUR BUSINESS PARTNERS

We enjoyed a very good year in 2003 and achieved record results. However, in our ongoing effort to thoroughly communicate with you, our partners, we will attempt to fully discuss both the good and the bad of 2003.

First, here is some of the good news. Gross written premiums grew 16% to $2.6 billion, most business units earned exceptional underwriting profits, investments and cash reached a record $5.3 billion and net income totaled $123 million. Our investment returns were superior with equity investments earning a 31% rate of return. Book value increased 19% to $140 per share.

Despite this good news, the year included some disappointments as well. We suffered adverse loss development in three areas resulting in charges amounting to $181 million. Given the magnitude of these charges, we are pleased to have achieved a modest underwriting profit for the company as a whole.

The bad news in 2003 included the recognition of significant loss reserve deficiencies at our Investors Brokered Excess and Surplus Lines unit. While we pride ourselves on disciplined underwriting and conservative loss reserving, we clearly missed the mark in this business unit as we increased reserves, primarily for the 1997 to 2001 accident years, by $91 million during the year. We believe the underwriting and pricing issues identified in 2003 were resolved over the past two years as market conditions significantly improved. Our



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internal claims review is complete and we believe the current business is well priced and underwritten and reserves for all periods are adequate. This experience reminds us that even in our culture of conservative reserving and underwriting, constant vigilance is a necessity.

Additionally, asbestos claims continued to be an expensive issue for Markel. We are fortunate that we and the companies we acquired were only minor players when asbestos exposures were written by the industry. Our market share in the pre-1986 period was less than 1%. We wish it were even less. As a result of our modest participation, we are not in a position to control what seem to be totally irrational claim settlements. While it is true that on an individual basis a plaintiff and his attorney may hit the lottery with an insurance claim, in the aggregate, the cost of claims is ultimately recycled in the form of future insurance premiums. There are no free lunches. We are fortunate, however, that we are participating in today's market in a much more material way as industry pricing recovers the losses from these frustrating events. The problems with asbestos as well as other tort reform issues are now on the agenda of Congress and many state legislatures and we hope for improvement in the current system.

Finally, discontinued business and prior year development at Markel International were also a drag on our 2003 results. Although you can never be completely confident about ultimate results early on, we feel extremely good about our risk selection and pricing in the most recent years and look forward to the day when we will be sharing better news about Markel International's success.

We set high standards and goals for ourselves, and are naturally disappointed when we fail to achieve them. 2003 was a very good year, but it could have been a great year. Nevertheless, we remain proud of our long term record of compounding book value and are optimistic about our ability to continue to do so.

## 2003 FINANCIAL REVIEW

Now for some more about the good news.

Revenues increased 18% from $1.8 billion to $2.1 billion as we continued to enjoy growth in both price and volume of our business. Earned premiums increased 20% to $1.9 billion and, more significantly, our combined ratio was 99%. While smaller than we would like, we are pleased to report an underwriting profit, our first since the acquisition of Gryphon and Markel International.

Total investment returns for 2003 were 10.5%. Our equity returns were 31% while fixed income securities earned a 4.5% return. Investment income increased 7.3% to $183 million as the average size of the portfolio grew to $4.8 billion. Net realized investment gains were $45 million and the change in gross unrealized gains was $141 million. These results represent an excellent year for our investment operations and demonstrate the importance and value of superior investing activity for our business.

Net income was a record $123 million, up from $75 million in the prior year, or $12.52 per diluted share as compared to $7.65. Comprehensive income was $222 million as compared to $73 million last year.

During the year investments and cash increased by $1 billion to $5.3 billion at year end. In addition, during the year we steadily increased our allocation of the portfolio to equities and at year end have $969 million invested in great companies.

Shareholders' equity increased to $1.4 billion. Year end book value per share is $140, up 19% for the year. In the past 5 years we have compounded book value per share annually by 13% and in the past 10 years by 18% (including the effect of stock issuance).

## EXCESS AND SURPLUS OPERATIONS

Gross written premiums in 2003 for our Excess and Surplus segment were $1.5 billion which represents a 15% increase over the prior year. We continued to have more opportunities to write business and at higher prices, although the rate of increase was at lower levels than we experienced in 2001 and 2002. While we believe price increases will moderate, we expect the market to continue to be very favorable. It is important to emphasize that our current prices should generate good underwriting results.

Excess and Surplus earned premiums increased 34% to $1.0 billion reflecting the strong growth in written premiums in prior years. More importantly, the combined ratio was 90% despite the development at Investors compared to last year's very respectable 93%.

Each business unit in our Excess and Surplus segment is participating in a very favorable insurance environment. Premium volume, pricing and underwriting profits are attractive throughout the segment. Our talented and experienced underwriters are continuing to respond to the needs of our clients by providing quality specialty insurance solutions.

## SPECIALTY ADMITTED OPERATIONS

Our Specialty Admitted segment also had an excellent year as gross written premiums increased 15% to $271 million, earned premiums increased 27% to $235 million and the combined ratio declined to 90%. Price levels achieved in the past few years along with our underwriting focus are providing sound underwriting profits. The marketplace for this segment continues to provide a positive platform for both organic growth in our current niches and for new product development and expansion opportunities.

## LONDON INSURANCE MARKET OPERATIONS

For 2003, Markel International wrote $738 million in gross written premiums, an increase of 19% over last year.

Earned premiums were $575 million with a 104% combined ratio which was slightly better than the 107% reported last year. Unfortunately, underwriting profitability still evaded us as in the fourth quarter we recognized $15 million in adverse loss development from prior years. Throughout the past three years we have seen progressively better underwriting results from new business that we put on the books. We continue to be dedicated to a conservative loss reserving discipline. We also continue to resolve old issues and we are cautiously optimistic regarding the profitability of the current business.

In 2003, we changed the management team at Markel International. Gerry Albanese moved to London to become President and Chief Operating Officer after serving us extremely well as the chief underwriting officer at the Shand Professional/Products Liability operation. Additionally, Richie Whitt joined Gerry as Executive Vice President and Chief Administrative Officer having previously served the company as our Corporate Controller and Treasurer. Gerry and Richie have a combined 30+ years at Markel and reinforce the Markel Style in London. Their presence in London demonstrates our commitment to Markel International. They are off to a strong start, our London associates are excited, and we are confident that our team in London will be successful.

Business in the London Insurance Market segment is showing continual improvement and we expect underwriting profits and solid returns on our capital. We will never underwrite business just to generate cash flow and have not yet reported underwriting profits. However, it is important to point out that Markel International has a growing investment portfolio which reached $2 billion in 2003. While we do not allocate investments for purposes of segment reporting, we should not forget that the returns on the investment portfolio mitigate the impact of underwriting losses.

## OTHER

"Other" includes programs and lines of business related to previous acquisitions which have been terminated or placed into run off. It also includes certain matters involving disputes and litigation. The majority of this business is related to our acquisition of Markel International in March 2000 when we discontinued about 35% of the then existing business. Other also includes our exposure to environmental and asbestos claims which were acquired with our purchase of Evanston Insurance Company in 1990, Associated International Insurance Company in 1999 and Terra Nova Insurance Company in 2000. Finally, included in this segment is the operation of our French reinsurance company, Corifrance, which while small, is operating with good underwriting results.

During 2003, we made meaningful progress in resolving a number of outstanding issues involving our exposures in discontinued programs; however, in doing so we discovered that it was necessary to increase our reserves by $75 million.

Of this amount, $55 million was for asbestos and $20 million for several other discontinued programs. We cannot precisely forecast when these legacy issues will cease, but are confident that we are effectively managing this process.

## INVESTMENTS

Our business model emphasizes the importance of superior investing, significantly more so than most insurance companies. Having a disciplined approach to investing and managing investments to achieve sound returns adds significant value for Markel shareholders. In 2003, we earned a 10.5% tax equivalent total return, including the effects of foreign currency, on our investments where equities returned 31% and fixed income securities returned 4.5%. Given the environment, this was a truly superior investment performance. The following chart shows our performance over the past year, as well as 5 and 10 year periods and compares our returns to those achieved by standard market indices. We do not manage against an index nor do we think in relative terms, however, the comparison does demonstrate the value added by our approach to investing over long time frames.

| | One Year | Five Years | Ten Years |
|---|---|---|---|
| Markel Total Return | | | |
| Fixed maturities | 4.50% | 7.00% | 7.20% |
| Equity securities | 31.00% | 13.20% | 15.10% |
| Market Indices | | | |
| Lehman Aggregate Index | 4.10% | 6.62% | 6.95% |
| S&P 500 | 28.37% | (0.55)% | 10.56% |

Over the past year we continued to shorten the duration of our fixed income portfolio as we remain leery of increasing interest rates. We believe interest rates are more likely to move up than down and we are unwilling to stretch for yield by either extending the duration or giving up credit quality. The relatively low interest yield in fixed income securities also makes the choice to allocate more funds to equity securities easier. While maintaining our high quality and relatively short duration portfolio, we are pleased with our performance.

It is important to think about our investment returns in dollar terms rather than just percentages. Over the past decade, our investment decisions regarding equity allocations, as well as specific security selections, have added literally hundreds of millions of dollars to shareholders' equity.

During the year we steadily increased our allocation to equities. A year ago equities were $551 million or 13% of the portfolio and 48% of shareholders' equity. Today we have $969 million in equity investments which is 18% of the portfolio and 70% of shareholders' equity. This increase results from higher equity allocation (as discussed in last year's report) because we found more quality opportunities at favorable prices and the value of what we owned increased. Additionally, our insurance operations are generating significant cash flow with very good margins, which provides capital and regulatory flexibility to increase our equity portfolio.

At year end the total unrealized investment gains before taxes were $417 million. After providing for the deferred tax liability in the amount of $146 million, the net unrealized gains included in book value were $271 million. It is important to note that the deferred tax will not be paid until and unless the individual securities are sold and the gain realized. The ability to defer this tax payment for a long time (maybe forever) is an important benefit. It is very much like having an interest free loan from the government. It is one of the reasons we prefer unrealized gains to those we realize and why we prefer to invest in good companies which we can own for the long term. And, of course, it is an additional reason why we measure our success by looking at growth in book value per share over the long term. Our equity portfolio turnover is typically less than 10%. This is quite unusual in the institutional investment world where turnover is frequently well in excess of 100%.

## BALANCE SHEET/CAPITAL ISSUES

Investments and cash grew 24% to $5.3 billion from $4.3 billion last year. The $1 billion increase is primarily the result of $631million in operating cash flow, $141 million in increased unrealized gains in the portfolio, and an increase in net borrowings of $115 million. Our investment leverage (the ratio of investments and cash to shareholders' equity) was 3.9 to 1.

As previously discussed, we increased loss reserves for prior years' exposures by $181 million. At the same time we recognized net favorable prior year development of $52 million. This softened the impact of the bad news and the net adverse development for the year was $129 million. We continue to maintain our long standing policy of seeking to establish loss reserves at levels which we think are more likely to be redundant than deficient.

At year end shareholders' equity grew 19% to $1.4 billion or $140 per share. We are well capitalized to achieve our current business plans.

It is absolutely critical for any insurance company to maintain a strong financial position to honor the promises it makes to its policyholders. At Markel, we firmly believe we offer our clients the security and financial protection they need through the combination of our sound underwriting, diligence in establishing loss reserves, superior investing and our strong capital position.

## CORPORATE GOVERNANCE

Corporate governance issues continue to be an important topic. This is nothing new to Markel. To quote Barbara Mandrell, "we were country when country wasn't cool." We believe we have always met the true spirit of sound corporate governance in making good decisions, treating all shareholders fairly and fully disclosing all important aspects of the Company's business and operations. To comply with the most recent regulatory requirements which dictate that a majority of the board be independent directors, Tom Gayner, Gary Markel and Darrell Martin will not stand for re-election as directors at the next annual shareholders' meeting. As a result, our Board will be comprised of 7 directors, 4 of whom are independent. Tom, Gary and Darrell have been valuable directors and have represented our shareholders well. While they will not continue to serve as directors, their voices will continue to be heard by the Board. Additionally, Tom and Paul Springman will join the expanded executive management committee.

While many of the new regulations are well intentioned and seek to achieve admirable goals, these rules cannot guarantee honesty and integrity. Unfortunately, these new requirements will add bureaucracy and cost and the ultimate benefit is not clear. We estimate that in 2004 we will spend as much as $3 million to comply with these new procedures. While we will clearly have additional paper, procedures, flow charts and documentation, it is important that the additional bureaucracy not get in the way of good decisions.

At Markel we believe we have consistently met both the letter and the spirit of the law in providing full and complete disclosure. We have reported all the news, both good and bad, in an honest and forthright manner. More importantly, we have always treated our shareholders as our business partners, as in fact they are.

## THE FUTURE

The insurance industry experienced 15 years of soft pricing and poor underwriting before the market began to turn in 2000. After only two full years of a truly "hard" insurance market, many are forecasting the next turn. While price increases are starting to slow, they are still going up with only a few exceptions. As the year unfolds there will undoubtedly be additional examples of a more competitive insurance environment. We will not enjoy the "hard market" forever. But having said that, we believe we are more likely to see a "good" market for some period — maybe several years. Industry-wide balance sheet problems continue to exist, the asbestos problem has not gone away and investment yields in the fixed income markets do not justify irrational cash flow underwriting. We expect the favorable market conditions to last a while longer, but even more importantly, we believe we can earn good returns throughout all market cycles.

In 2003, we earned only a modest underwriting profit as several disappointments offset some truly remarkable underwriting results. In 2004 and in future years, we will be looking for solid underwriting margins as well as superior investment returns to continue our growth in book value.

Over the long term we've achieved significant success in spite of our share of things that have gone wrong. Clearly we've done a lot more things which have proven to be successful. While we will strive to make fewer mistakes, do more things right and fix our mistakes as quickly as we can, we will not avoid all risk, take no chances and stand still. We will continue to seek out challenges and capitalize on new opportunities.

We believe that the best way to learn to ride a bike is to get on it and start peddling. The bruises and scrapes we encounter along the way are an inevitable part of building our successful organization.

## OUR ASSOCIATES

One of Markel's greatest strengths is our wonderful and talented team of some 1,700 associates. While making important contributions to their individual business units, they have also been available and willing to pitch in with company-wide projects and needs. Examples include the design and implementation of our global financial system, the work of our multi-unit peer claims review team and various joint projects involving both our U.S. and international associates. Our associates embody the Markel Style each and every day. In an effort to continue to build and enhance our human capital, we recently established more extensive in house training and career planning programs which will help cultivate and develop our outstanding associates.

In closing we would like to thank all Markel associates who have worked tirelessly to serve our clients as well as our shareholders and have achieved great results. Likewise we thank our shareholders who have entrusted their capital with us.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*President and Chief Operating Officer*

Steven A. Markel
*Vice Chairman*

Darrell D. Martin
*Executive Vice President and Chief Financial Officer*

*From left to right: Alan I. Kirshner, Anthony F. Markel, Darrell D. Martin, Steven A. Markel*

2004

# TO OUR
## BUSINESS PARTNERS

Markel will celebrate its 75th anniversary in 2005. Sam Markel founded the company in 1930 with many of the business values we embrace today; values that are timeless and will continue to guide us for the next 75 years. We went public in 1986 and built one of the strongest specialty property and casualty businesses in the United States. In 2000, we expanded our base internationally more than doubling the size of our business. Long-term business success is the result of many factors including good luck. In our case, we attribute much of our success to having great people who focus on the Markel Style, which defines our common values, and our Commitment to Success. While much transpired during our first 56 years, here's what we have accomplished as a public company:

| Year | Shareholders' Equity | Book Value Per Share |
|---|---|---|
| | ($ in 000's) | ($) |
| 1986 | 14,790 | 3.42 |
| 1987 | 20,129 | 4.66 |
| 1988 | 45,414 | 9.22 |
| 1989 | 60,447 | 11.69 |
| 1990 | 54,659 | 10.27 |
| 1991 | 83,137 | 15.59 |
| 1992 | 109,342 | 20.24 |
| 1993 | 150,678 | 27.83 |
| 1994 | 138,501 | 25.71 |
| 1995 | 213,442 | 39.37 |
| 1996 | 268,335 | 49.16 |
| 1997 | 356,804 | 65.18 |
| 1998 | 425,301 | 77.02 |
| 1999 | 383,419 | 68.59 |
| 2000 | 752,372 | 102.63 |
| 2001 | 1,085,108 | 110.50 |
| 2002 | 1,159,111 | 117.89 |
| 2003 | 1,382,279 | 140.38 |
| 2004 | 1,656,503 | 168.22 |

This represents a 24% compound annual growth in book value per share since 1986.

Results for 2004 set many records. Earned premiums exceeded $2 billion with a combined ratio of 96%. Net income for the year was $165 million; comprehensive income was $273 million and shareholders' equity grew to $1.7 billion or $168.22 per share. Growth in book value per share over the long term is our overriding financial goal. We enjoyed compound annual growth of 20% over the past one-year and five-year periods and 21% compound annual growth over the past 10 years.

We achieved these results in spite of approximately $80 million of losses from the Florida hurricanes. The 2004 hurricanes were worse than we've seen in many years, but certainly less severe than if they had hit major metropolitan areas. We should also point out that our results were favorably impacted because we had no major earthquakes, hail storms, typhoons or other exceptional losses. The disastrous tsunami in Southeast Asia, which resulted in minimal financial losses to us, reminds us of the magnitude of potential exposures that do exist.

The very nature of our business is that in most years our results will be adversely impacted by one event or another. We learn to expect the unexpected. We hope that not too many bad things will happen at the same time. And we manage our exposure by having a large and diverse book of business across many products and locations. While many would like to see smooth and steadily improving results year after year, the reality is that our business is lumpy. Fortunately, over time, we have managed these risks well and earned solid returns on capital. The result can be seen in our long-term growth in book value per share. We continue to be dedicated to increasing book value per share at a high rate over the long term and remain optimistic that we will be able to do so.

## 2004 FINANCIAL REVIEW

Revenues increased 8% to $2.3 billion as insurance industry pricing stabilized from the extremely rapid rate increases of 2001 to 2003. Earned premiums increased 10% to $2.1 billion. Gross written premiums declined 2% while net written premiums increased 4% as we continued to decrease our reliance on reinsurance. The higher rate of growth for earned premiums represents the lag effect of earning premiums over the policy term. Most significantly, underwriting profit improved as the combined ratio declined from 99% in 2003 to 96% in 2004.

Taxable equivalent total investment return for the year was 7.9% with equity returns of 15.2% and fixed income returns of 4.8%. Investment income increased by 12% to $204 million as the portfolio increased from $5.3 billion to $6.3 billion. During the year we increased the allocation to equity securities to $1.3 billion or 21% of the total portfolio. The fixed income portfolio remains short in duration and very high in quality due to our concerns about the possibility of higher interest rates in the future.

Our record results are a reflection, in part, of the underwriting discipline possessed by each of our eight business units. While we aggregate our business units into three reporting segments for financial reporting purposes, each business unit contributes to our success.

## EXCESS AND SURPLUS OPERATIONS

Our Excess and Surplus Lines segment produced record underwriting profits of approximately $148 million during 2004. A summary of significant highlights for each operating unit in this segment follows.

**Essex Excess and Surplus Lines.** Our flagship operation, the Essex Excess and Surplus Lines unit, will celebrate its 25th anniversary during 2005. Essex has historically been one of the most profitable excess and surplus lines companies in the industry and 2004 was certainly no different. Our contract property and contract casualty divisions have produced excellent profits and, in spite of the four Florida hurricanes, our conservative underwriting approach to catastrophe exposed business also produced an underwriting profit this past year. Our other specialty products including inland marine, ocean marine, transportation and railroad were all solidly in the black. This was an exceptional year for this team of professionals.

**Shand Professional/Products Liability.** Our professional liability underwriting arm, the Shand/Evanston group, had equally exceptional results. Over the past decade, Shand has become a market leader in employment practices liability coverages for the small to mid-size buyer. Our disciplined approach, loss control and safety engineering services and educational seminars set us apart from the vast majority of the competition. Our claims-made products liability business produced significant underwriting profits in every year but one since 1990. Our medical malpractice portfolio consisting of physicians with special needs and new and emerging medical technologies, which we call specified medical covers, have combined to become a major portion of the Shand product mix. With the retrenchment of other medical malpractice insurers over the last few years, Shand has become known as a problem solver and leader in this arena.

**Investors Brokered Excess and Surplus Lines.** In spite of the adverse development recognized at Investors, we believe our prospects for the future have never been brighter given the new leadership in place at this operating unit. Both our excess and umbrella and our primary casualty books of business have been re-underwritten over the last couple of years and we have confidence in the future profitability of these products. Our property business has been a consistent money maker in every year since our 1996 acquisition. Our newer products including various environmental coverages and our taxi business have established excellent track records during their short tenure and should produce underwriting profits for us well into the future.

**Markel Southwest Underwriters.** This operating unit became part of Markel in early 2000. The first two years under Markel ownership, we retooled this business unit, completely overhauling the underwriting and claims approaches from the business that we acquired. In each of the three subsequent years, margins have improved. We are extremely proud of the progress that our Scottsdale team has made. They have been able to duplicate the success of our excess and surplus lines businesses by providing superior products and services to the wholesale brokerage community.

**Markel Re.** Our casualty facultative reinsurance operations, started in the fall of 2002, have established a name and presence for themselves in today's marketplace. Their individual account underwriting approach and focus on bottom line profitability have assisted us in maximizing market opportunities. SMART (Specialized Markel Alternative Risk Transfer) was added to Markel Re in the summer of 2003. Our seasoned team has national recognition and we are confident that their disciplined underwriting approach will benefit Markel over the long term.

## SPECIALTY ADMITTED OPERATIONS

Our Specialty Admitted segment also had record results, producing underwriting profits of $38 million in 2004.

**Markel Specialty Program Insurance.** This underwriting unit has produced profits in 9 of the last 10 years. We are clearly a market leader in many of our core property and casualty products including camps and daycare. Our devotion to safety and loss control engineering services as well as our exceptional attention to customer service requirements has served us well for many years. Our agriculture/equine portfolio also performed well above our profit expectations. This group of commercial lines specialty coverages is, in many ways, unique to the industry. We aim to expand our product mix in 2005 while maintaining our underwriting integrity.

**Markel American Specialty Personal and Commercial Lines.** Our personal lines specialty unit, located in Pewaukee, Wisconsin is one of Markel's technology success stories. More than two-thirds of the motorcycle accounts written this past year were sold over the Internet. Our bike-line.com site has been operational for 5+ years with many enhancements added along the way. Customers can easily access the site at their convenience receiving quotes, binding coverage and paying for their policies all online.

## LONDON INSURANCE MARKET OPERATIONS

While not yet reporting underwriting profits, our London Insurance Market segment produced approximately 28% of our 2004 gross premium volume. We believe our London operations provide an excellent opportunity for international expansion and we are increasingly confident that they will produce the same strong underwriting performance we achieve with our U.S. operations.

**Markel International.** When we purchased what was then known as the Terra Nova Group in March 2000, we anticipated that we would be dealing with the legacy issues and the run off liabilities associated with any 30+ year old organization for the first few years of our ownership. While that is exactly what transpired, the effort was certainly more expensive than expected. Now, with most of the legacy issues resolved, we are focusing on the future. Later this year, we will be opening a new service office in Madrid, Spain and are exploring expansion into Canada. Our retail UK business has produced extraordinary returns and we will be opening new service offices during 2005 in addition to the four established retail centers that now underwrite and market specialty products. Our core professional indemnity product remains extremely strong and our market leadership position and visibility continues to grow in the London marketplace. While under some pricing pressure, the remainder of our core products, which include specialty property, casualty and marine insurance, are positioned extremely well to achieve our underwriting objectives in the upcoming year.

## INVESTMENTS

Our business model emphasizes the importance of superior investing and our investing results have added a great deal to our long-term growth in book value. Having a disciplined approach to investing and managing investments to achieve sound returns adds significant value for Markel shareholders. In 2004 we earned a 7.9% taxable equivalent total investment return where equities returned 15.2% and fixed maturities including our cash and short-term investments returned 4.8%.

The following chart shows our performance over the past year, as well as 5- and 10-year periods and compares our returns to those achieved by standard market indexes. We do not manage against an index nor do we think in relative terms, however, the comparison does demonstrate the value added by our approach to investing over long timeframes.

| | One Year | Five Years | Ten Years |
|---|---|---|---|
| Markel Total Return | | | |
| Fixed maturities | 4.8% | 6.9% | 6.8% |
| Equity securities | 15.2% | 16.1% | 15.6% |
| Market Indices | | | |
| Lehman Aggregate Index | 4.3% | 7.7% | 7.7% |
| S&P 500 | 10.7% | (2.4)% | 11.6% |

Over the past year we continued to maintain the short duration of our fixed income portfolio. We believe interest rates are more likely to move up than down and we are unwilling to stretch for yield by either extending the duration or giving up credit quality (as you may note we used the same words last year and we believe they are equally true today). Given our desire to maintain a high quality and relatively short duration portfolio, we are delighted with our results.

During the past three years we have significantly increased our allocation to equities. Three years ago equities were $551 million or 13% of the portfolio and 48% of shareholders' equity. Today we have $1.3 billion in equity investments which is 21% of the portfolio and 81% of shareholders' equity.

Our increasing allocation to equities stems from the combination of our increasing financial strength and improving underwriting results, as well as attractive equity investment opportunities. Equity securities are nothing more than fractional ownership interests in a business. Over time prices of shares reflect the underlying value of those businesses. We expect that those values will increase at a faster rate than the rate of interest offered by high quality fixed income alternatives. Therefore, we look to allocate capital to equities as circumstances and opportunities permit.

In any given year, positive and negative events occur. During 2004 positive events included our investment in Fairfax Financial Holdings which appreciated in excess of $30 million. Negative events included the decline in value of our investment in Marsh & McLennan Companies by approximately $17 million following the Spitzer allegations and investigation. However, in aggregate, our results for 2004 and over the past 5- and 10-year periods have proved quite satisfactory.

We believe there are two fundamentally distinct approaches to making money in investment markets. "Traders" attempt to benefit from price volatility and successfully trade positions to earn profits. "Investors", by contrast, seek to own profitable businesses at reasonable prices and benefit from the underlying growth in the business they own. In the short run, being a skillful trader is important. As the noted investor John Templeton said, "Share prices fluctuate more than share values." In the long run, however, investing ability becomes more important. The financial skill to identify profitable businesses at reasonable prices and, having the temperament to stick with them through ups and downs, generate favorable long-term returns.

We are investors, not traders. We are pleased with the businesses we've bought over the last several years as we've increased our allocation to equities and we are optimistic about their future prospects. While year-to-year returns will fluctuate with the moods of the stock market and company specific events, we expect our returns as investors over time to be similar to the underlying returns of the businesses themselves. Given the businesses we own, we are happy with that prospect.

## BALANCE SHEET AND CAPITAL STRENGTH

Our primary goal regarding our balance sheet is unquestioned financial security. Our second goal is appropriate financial returns for our shareholders. At year end our business is capitalized with $1.7 billion of shareholders' equity, $610 million in senior long-term debt, $150 million in junior subordinated debentures and $95 million in convertible notes payable.

During the year we raised approximately $200 million through the issuance of 7.35% senior notes which mature in 2034. The proceeds of this transaction were used to pay off our revolving credit facility and for general corporate purposes. We remain concerned about the possibility of rising interest rates and wanted to lock in a fixed interest rate for the long term. We also liked the idea of adding 30-year capital to our balance sheet. Of the remaining senior long-term debt, $166 million matures in 2007 and 2008 and $248 million in 2013.

The junior subordinated debentures have equity-like features in that we have the right to defer interest payments for up to five years and the final maturity is not until 2046. Given the subordination features and the long-term maturity, we include this as equity in our debt-to-equity calculations. These securities are also redeemable by us beginning in 2007.

The convertible notes payable also have some unique features. While these are zero coupon notes, each year they increase in value by 4.25%. The notes have a final maturity of 2031; however, the holders have certain rights to redeem the notes or convert them into Markel shares. If the notes are redeemed, we may choose to settle in either cash or Markel shares. While we do not pay current interest on the notes, the accrued interest is a tax deductible expense. If these securities were converted into common shares, we would issue approximately 335,000 new shares. As a result of a new accounting standard, this dilution is now included in our earnings per share calculations. With this dilution net income per share has been reduced by approximately 2%. Coincidently, if these notes were converted into common shares, book value per share would increase by approximately 2%.

Since our initial public offering, we have believed that the appropriate financial structure for our business was roughly one-third debt and two-thirds equity. We continue to think this is a good balance that provides a secure position to our policyholders and high returns for our shareholders.

When we completed the acquisition of Terra Nova in 2000 and assumed the operating issues of that company, the rating agencies reduced the ratings on our bonds. While we believe we have now resolved the vast majority of those operating issues, the agencies have been very slow to restore the ratings to levels we think appropriate. Clearly we're biased in this view. The agencies are independent, don't care much about our opinion and will come to their own conclusions.

Undoubtedly, as we continue to demonstrate superior financial performance, higher ratings will follow.

Our unwavering goal is to manage our business and financial structure to maintain a strong financial position. With profitable underwriting performance, a conservative loss reserving philosophy and an appropriate amount of well-structured, long-term debt, we believe we can achieve and maintain strong debt ratings.

## CORPORATE GOVERNANCE

The Sarbanes-Oxley Act of 2002 brought many changes to the way public companies operate. Many, maybe even most, seem like bureaucratic overkill in an environment where a few were simply dishonest. Section 404 of the Act required complex, time-consuming and very expensive processes to test internal control procedures and assure their effectiveness. Many have questioned its value. Over the past year, almost everyone at Markel has been involved in one way or another to document compliance with Section 404. The process was every bit as complex, time-consuming and expensive as we expected and we are pleased we have successfully completed the task. While the task seemed daunting at its inception, we are pleased that much of the process will improve our systems and operations. The expanded understanding across the entire organization that everyone is responsible for the quality of our business and our internal controls is also a good thing.

The insurance industry also came under direct attack as the New York Attorney General investigated illegal bid rigging in the industry. We are confident that we do not have problems with these issues and we will continue to emphasize to all of our associates the importance of our values which require "honesty and fairness in all our dealings." These long-standing values coupled with appropriate policies, procedures and compliance efforts serve us well. We are trying as best we can to follow the example of the Quakers who came to America to "do good, and did well."

Good corporate governance starts at the top. We are fortunate to have a great Board of Directors (particularly the outside, independent directors) to help oversee our operations and to provide a strategic direction for the Company. They embrace the Markel Style and make sure we live up to those high standards. The diverse talent of the Board continues to expand and we are especially pleased that Al Broaddus joined us as a director in August. Al, a native of Virginia, received his undergraduate degree from Washington & Lee University and M.A. and Ph.D. degrees from Indiana University. He served an illustrious career with the Federal Reserve Bank of Richmond starting as an Economist in 1970 and rising to President in 1993. He retired as President from the Fed this past summer. Our meetings will not compare to the Federal Open Market Committee meetings and the press is unlikely to wait eagerly for our pronouncements, but Al's broad knowledge, experience and sound judgment will be very valuable to Markel.

## EXECUTIVE MANAGEMENT CHANGES

Darrell Martin, Executive Vice President and Chief Financial Officer, announced in early January 2005 that at the next shareholders' meeting he will pass on his responsibilities as CFO to Richie Whitt and move into a reduced time role. Darrell first became associated with Markel while he was a member of our independent auditors, KPMG, and worked on our account. He became the partner on our account in 1985 the year before our initial public offering. Darrell joined Markel as our Chief Financial Officer in 1988 and has been an instrumental part of the executive management team since that time. Darrell will continue as Executive Vice President and give us approximately 25% of his time while he tests the waters of retirement. Richie joined Markel in 1991 as Manager of Accounting and has made Darrell look good ever since. After continually advancing in the accounting and finance areas, Richie moved to London in 2003 to work as Chief Administrative Officer at Markel International. There he has obtained some very valuable operating unit and international insurance market experience. Our financial affairs will remain in very good hands with Richie and we are very fortunate that Darrell will continue to be available to guide us and offer his wise counsel.

## OUR FUTURE IN A COMPETITIVE MARKET

After many years of an increasingly competitive environment, the insurance market showed dramatic improvement in the few years following the tragic events of September 11, 2001. After a too short recovery, pricing in the industry is now showing weakness. While much of our business is holding up with adequate pricing and underwriting conditions, there are an increasing number of examples where companies are chasing business without due regard for underwriting and pricing considerations necessary to earn decent returns on capital. As shareholders and business partners you can be sure Markel will not go down this path. Our premium growth may slow in this environment, but we remain committed to our business principles and corporate values.

In fact, one of Markel's greatest strengths is our consistent focus on a business model…our Model for Profit…where the combination of underwriting profits and investment returns build shareholder value over the long term. Growth in premium volume is not critical to this model. Yes, growth is nice. Yes, growth is important to our long-term success and development. Yes, we are always looking for new opportunities and we will compete for every piece of profitable business we can. But for Markel, underwriting profits come first.

We have a lot of experience in growing our business profitably in a very competitive environment. In fact, that is where we really shine. There are many factors, strategies, and issues that enable us to be competitive without sacrificing our underwriting standards.

Whether the market is "hard" or "soft," one of the first and most important business strategies is to renew our existing business. We do this by providing great service which can only be done with focused and committed associates. Markel is a great place to work. Our incentive plans reward underwriting profitability by sharing underwriting profits with those associates who earn them. True insurance underwriters find the environment at Markel to be one they want to be a part of. We reward success and focus everyone on profit, not volume.

Another option for growth is to increase the proportion of the business we retain by using less reinsurance. This is already taking place. In 2004 we retained 81% of our gross written premium as compared to 77% in 2003. The 4% increase amounted to over $100 million in premium volume. We expect that this process will continue in 2005 as our growing capital and good experience with the business allows us to assume additional exposure. We will, of course, always purchase sufficient quality reinsurance to conservatively protect our financial position.

As the insurance market softens, we continue to look for opportunities to add people and acquire business or companies which can enhance value for our customers and shareholders. New opportunities for expansion are always available and we expect to take advantage of those opportunities when they arise.

As we continue to grow, we remain mindful of the importance of our human capital and internal training programs. To further expand our ability to hire and develop the next generation of Markel associates, we formed Markel University. Since its first class began in the fall of 2002, we have hired 13 recent college graduates who have or will very shortly complete this program and become valued, productive Markel associates.

Our investing philosophy also continues to be a critical element of our business model. We typically allocate roughly 80% of our investment portfolio to fixed income securities with the remaining 20% to equity investments. This allocation matches insurance liabilities with fixed income securities and shareholders capital with equity investments. Our foremost goal is to make sure we have capital available to our underwriters to write profitable insurance business. If, however, there are fewer opportunities to do so or if our capital were to grow faster than insurance opportunities, then we can increase the portfolio allocation to equities. Over time, this will increase the total return we can expect to earn from our investing activities so that we can continue to deliver a high growth rate in book value per share.

A final alternative is to return capital to our shareholders. If we cannot earn high returns on our capital, we clearly recognize our obligation to our shareholders to return that capital. This could take the form of either cash dividends or share repurchases. We currently believe, and our track record would suggest, that we have great opportunities to invest your money in the business, so we do not expect that either of these alternatives will occur in the near term, however, we will remain cognizant of these alternatives as stewards of your capital.

## CLOSING COMMENTS

The great thing about recognizing milestones is they present an opportunity to reflect on the past while focusing on the future. The excitement of celebrating our first 75 years is matched with equal optimism about the next 75. The fact that this business has succeeded by embracing a culture with specific values gives us confidence and direction for the future. Our underlying values and the relationships and integrity they produce remain durable and valuable for 2005 and beyond.

When new people join Markel, they are often recruited by existing associates. They want to join a winning team and one that wins by doing things the right way and in accord with important values. This becomes a flywheel with momentum that helps perpetuate the ability to grow and manage a profitable business in the future. We need good people to grow this business and good people want to join us in order to work in an environment of which they are proud.

Similarly, the shareholders of Markel also are committed to our long-term success. A large percentage of our shares are held by associates who view ownership of Markel as a critical piece of their financial future. Our external shareholders also tend to be long-term owners of the business and have provided us with financial capital, ideas and support that help us achieve our goals.

Over time, the daily execution of these ideas and the daily walk in accord with our values builds credibility for Markel with our associates, our shareholders and our customers. Every day that we do this creates increased evidence and credibility that we will do it again tomorrow. This is a wonderful consequence of being in business for many years. Credibility is a fragile asset to be guarded. We know the value of our heritage as well as the stakes for the future, and we look forward to continuing to earn your trust in the years to come.

We thank our associates for living and executing the Markel Style and making our success possible. We thank you, our shareholders, for your continued support.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*President and Chief Operating Officer*

Steven A. Markel
*Vice Chairman*

Darrell D. Martin
*Executive Vice President and Chief Financial Officer*

Paul W. Springman
*Executive Vice President*

Thomas S. Gayner
*Executive Vice President and Chief Investment Officer*

*From left to right: Paul W. Springman, Anthony F. Markel, Darrell D. Martin, Steven A. Markel, Alan I. Kirshner, and Thomas S. Gayner.*

# <u>Markel Meeting in Omaha – May 1, 2005</u>

The meeting started out with Steven Markel making some introductory comments:

- 2005 – Markel is celebrating its 75th Anniversary, founded by Steven's grandfather Sam Markel

- Went public in 1986

- Business model – to earn consistent underwriting performance, superior returns and to build shareholder value

**Finite reinsurance and how big is the problem?**

Steven:

I don't know. There's a big grey area of what is and what isn't finite. But it is huge. (Spoke about Frontier) A lot of it is legitimate business processes.

**Acquisitions in the last 4-5 years?**

Steven:

Growth is secondary to consistent profits and superior margins. We won't sacrifice profits for growth. (Aiming to grow at 20% per year, and growth can come from existing businesses, expand areas of business and acquisitions) In 2000, we doubled our size by acquiring Terra Nova.

**Finite effect on pricing cycle?**

Steven:

I guess not (in regards to any real effect). We've lived with these cycles in the past and we will again. It will have an impact but we don't know exactly how much.

**Compare Berkshire and Markel?**

Steven:

We don't write nearly as much catastrophe insurance. The sizes and aggregates we are willing to write are very modest compared to what Warren or Ajit would write.

**Pricing in your markets?**

Steven:

Some of the property lines are being affected, but in some of our other businesses they are doing better.  Our renewals are doing well, but new business is a little slower.

**NCB coverage as BRK is willing to accept on some contracts?**

Steven:

We don't write policies with that coverage.

**What competitive advantages do you have in actuarial services?**

Steven:

I don't think we have one.  Our target is to get into the 80% percentile of being right.  Actuaries provide only one piece of information, but a management team could push them into one direction or another.  How do you recognize an extroverted actuary?  He's the one looking down at your shoes, instead of his own!  We don't shut our actuaries in a room.  They work with our managers, analysts and investment team.

**Expansion into Europe and Asia?**

Steven:

We don't know about Asia, but are expanding into Spain, France and opening a Toronto office.

**5-year retrospect on Terra Nova?**

Steven:

Started out very bright, went very dim and now looking very bright again (Fairfax shareholders can relate here I guess).  The process cycle at Lloyd's of London is much slower than in the U.S.  We feel very good about the people we have now.  We were aided by the near implosion of Lloyd's in September 2001.  In March of 2001, what we had to say sounded stupid, but in October 2001, what we had to say sounded intelligent.  We were in front of the curve.  If you add up the pluses and minuses, we haven't made up what we've lost.

**Changes in contingent commissions?**

Steven:

Too early to tell how the brokerage industry will deal with it, but the immediate benefit to us is that our commission cost is lower.

**In 2004, how many underwriters earned more than Steven and how many were in the U.K.?**

At least one in the U.K., and probably 15 or 16 in the U.S.

Steven:

The underwriters have every objective to make the underwriting consistent and profitable over the long-term, since their compensation is tied to it (in reference to the fact that Markel's underwriters have part of their bonus structure tied to the long-term results of contracts). Underwriters need to be with us for a long enough time to believe in the culture, and that the rug won't be pulled out from underneath them once an objective is set.

**How do you manage reinsurance and how much business do you keep on your books?**

Steven:

Our underwriting goal is to make sure that the client receives 100% coverage at the right price, and we buy reinsurance when necessary. We try and retain as much of the business as we can.

**Equity and fixed income markets?**

I can't remember who spoke here, but it was either Tom or Steven. I'll just give the quotes spoken:

These are interesting times as the Chinese curse would say. I think the times we are living in, are one of those periods that happen once a generation. I did not foresee well what this back end of a cycle looks like. The bad guys for the most part are out of the market. But you have the slower, fatter folk who are in business through thick and thin are getting some of the blame. We are in the process of grinding out through the excesses of past years. On the fixed income side, we are worried about interest rates and our duration is short – about 4 years.

**Comment on 10-year treasury?**

Tom:

The first job we have is to protect capital. There are those that don't know, then there are those that don't know that they don't know! I never want to impinge on the underwriters job, but we would rather be wrong on the shorter side.

**Adding higher combined ratio businesses like worker's compensation or medical malpractice?**

Steven:

We very openly acknowledge that we may miss some opportunities, but the uncertainty of some of that long-tail business…we wouldn't be extremely comfortable with.

**On the Fairfax Financial connection?**

Steven:

It's the only transaction that I've been involved in directly. We thought we got it at a very good price. We've known management for a very long time. It's not without its risks, but we thought it was a pretty good opportunity.

Tom:

(Explained their investment in Fairfax with this quote) Smart people don't become stupid and stupid people don't become smart! Prem's got a very good record and we think he'll come back to that.

**On BUD and that Markel was in before Berkshire?**

Tom:

(Explained how he first became interested in BUD) When I was a kid, my dad had a liquor store. The Anheuser-Busch drivers went on strike, and my father said you can't have a liquor store without Bud, so he got a truck and me and my father drove over to the brewery and bought beer.

**How tough to add a new product line?**

Steven:

We have about 80-100 lines of business, and we are always trying to find changes where we can find opportunity.

**What have you learned and what would do differently in acquisitions?**

Steven:

I guess we would do a little more due diligence and spend a little more time on assessments.

**Comment on Marsh & McLennan?**

Tom:

(Tom first stated that he stands behind his comments on Marsh & McLennan that were in OID) I didn't foresee the subsequent scandals that came. That being said, who is going to be the top brokerage in the world ten years out? Near death experiences often tend to lead to companies that are significantly better.

2005

# TO OUR
## BUSINESS PARTNERS

During 2005, most of our businesses enjoyed excellent performance; however, our financial results were negatively impacted by hurricane losses. Underwriting results excluding the hurricanes were remarkably strong with profits of $234 million. Losses from hurricanes Katrina, Rita and Wilma of $246 million more than offset these results, leaving us with an underwriting loss of $12 million in 2005.

Total reported investment returns were also less than normal as our equity returns were sluggish, despite largely positive earnings in our portfolio of companies. In addition, fixed income markets fought the headwinds of rising interest rates.

We ended the year with net income of $148 million and comprehensive earnings of $64 million. These returns were below our expectations and history of normal returns at Markel.

The hurricanes dominated both the national and insurance industry headlines in 2005. Unfortunately, catastrophes are a normal part of life and the insurance business. We know they will continue to occur, but we do not know when, where, or how severe they will be.

While catastrophes and rising interest rates have made our business tough in the short run, the long-run record is very good and the future is full of opportunity. Our financial model is to earn consistent underwriting profits and superior investment returns. Though we fell short in 2005, and we'll try to fully explain why, we remain confident in our ability to achieve our goals in the future as we have in the past.

Markel will continue to write catastrophe-exposed insurance business and we expect to have losses from time to time. However, in managing this part of our business the following principles apply: first, we must earn enough profits in the good years to more than offset the bad ones; second, we must manage our aggregate exposures so that both individual product lines and the company as a whole are not unreasonably exposed.

In reviewing our catastrophe results, most of our products successfully delivered on these principles. However, there were some notable exceptions and with those products we are aggressively addressing the problems. We are increasing prices and reducing aggregate exposures where necessary. We are also reducing our reliance on industry catastrophe models and planning for higher frequency and severity of catastrophes in the future based on the experience of the past two years. Should we find the marketplace unwilling to allow us to achieve our profitability targets on this basis, we may find it necessary to withdraw.

Because the impact of these hurricanes was so significant to our financial results, in several cases throughout this report we will be referring to our results "before and after" or "with and without" the hurricane losses. Let us assure you that this is to help you better understand the business and what is happening. It is in no way an attempt to excuse or imply the events didn't really happen. We know all too well that they really did occur and, more importantly, that we can expect similar events in the future. We hold ourselves accountable for everything that happens at Markel and we clearly include these events in our compensation calculations.

In keeping with our efforts to be conservative and prudent, there is good news. While many companies have increased their estimated losses from hurricanes with each announcement, we believe that our initial estimates for Katrina and Rita now look to be too conservative. At the time of our third quarter financial release, we estimated losses from these events at $254 million. With the passage of time, the settlement of many claims, and the ability to better assess the losses, we estimated the costs of these hurricanes at year end to be $140 million for Katrina and $41 million for Rita, a total of $181 million or a reduction of $73 million from our original estimate. Hurricane Wilma, which occurred in the fourth quarter, cost us an estimated $65 million, so unfortunately this redundancy was used pretty quickly. Suffice it to say, we will continue to set loss reserves prudently.

## HURRICANES

Given the magnitude of the hurricane losses, we will try to explain what happened, how it impacted us, and most importantly, what we are doing about it. First, it is important to understand that the 2005 hurricane season was far and away the biggest and most costly on record. Hurricane Katrina is estimated to have caused insured losses of over $38 billion. To put this number into some perspective, Hurricane Andrew cost $16 billion in 1992 and total equity capital in the United States property and casualty insurance industry stands at approximately $400 billion today. Hurricane Rita followed in late September and Hurricane Wilma in late October, adding an estimated $13 billion in losses. Together these three storms will cost the industry approximately $51 billion. As a comparison, 2004, which was also a pretty tough year for hurricanes, and the previous record holder, cost the industry almost $29 billion.

We provide insurance coverage for losses related to hurricanes in many of our divisions and business units. Essex Special Property and Markel International's property division provide coverage for highly exposed property risks which often include coverage for wind, flood or earthquake. These risks are typically larger and have low frequency, but high severity. Simply put, the losses don't happen very often, but are very costly when they do. Approximately 48% of our hurricane losses was generated from business in these units.

Markel International's Marine and Energy division sells coverage for all aspects of oil and gas activities which includes drilling platforms in the Gulf of Mexico. Our London operations also sell property reinsurance which includes hurricane exposure. Each of these areas was responsible for about 12% of our hurricane losses.

In our three contract property departments at Essex, Markel Southwest and Markel International, we have exposure to wind losses in the southeastern states which contributed approximately 17% to our hurricane loss. About 15% of the premiums earned in these departments have hurricane exposure.

Markel American Specialty Personal and Commercial Lines had exposure in its watercraft, yacht and property departments. We even had motorcycle losses as a result of the hurricanes.

One of Markel's great strengths is that we have many different specialty products, over 90 at last count. This diversity of products normally adds stability, but in those circumstances where a single event (like a hurricane) impacts multiple products, it creates a challenge to effectively manage this risk. To help forecast the potential loss from a catastrophic event both within a single product and across the spectrum of our different products, we have used a combination of the three most recognized independent catastrophe models. These models are intended to simulate an event and establish damage estimates for insured exposures. Unfortunately, these models significantly underestimated the magnitude of damage from the recent hurricanes. We also underestimated the unusual frequency of large events in the past two years. The models will be enhanced and made more robust as a result of knowledge from recent events. In addition, we will augment the industry models with our own models and underwriting tools along with an even greater margin for safety.

Many experts suggest that the environment is changing and hurricanes are on the increase. Clearly the recent experience of 2004 and 2005 adds credibility to these ideas. For example, this year's storms, Katrina, Rita and Wilma, all rank in the top ten most costly hurricanes in the United States. They rank first, seventh and third. Last year's storms, Charley, Ivan, Frances and Jeanne, also rank in the top ten. They are fourth, fifth, eighth and ninth. It is surprising that the storms of the past two years represent seven of the ten most costly. Filling out the top ten were Hurricane Andrew in 1992 (second) which set and held the previous record until Katrina, Hurricane Hugo in 1989 (sixth) and Hurricane Georges in 1998 (tenth).

If one were to look at hurricane statistics over the past 10, 20 or 50 years, it would be much more difficult to conclude that hurricane activity is increasing. For example, after Hurricane Andrew in 1992 until the hurricane season of 2004, on average less than 1.5 hurricanes made landfall each year in the United States and only Hurricane Georges now ranks in the top ten. Given these facts, a more logical conclusion might be to expect less frequent and severe hurricane activity in the future. Storm activity is, of course, only part of the issue. Another important issue affecting the costs of hurricanes is that building and economic development in geographic areas exposed to hurricanes continues to increase. The rising values of properties developed in coastal areas have significantly increased economic losses from hurricanes.

The good news is that Markel and the insurance industry can respond to the needs for coverage. While higher property values increase exposure, they also increase the premium base to pay for coverage and inevitable future losses. As new properties are built, they are generally constructed to better withstand hurricane winds. The number and total value of properties exposed to hurricanes is huge, but the probability that any single unit will experience a loss is still remote. Insurance is based on the law of large numbers, and with intelligent underwriting, a spread of risk and sound pricing, the insurance industry and Markel can continue to profitably respond to the need for protection from hurricane losses.

We expect each of our products to earn underwriting profits and contribute to our growth in book value. We fully expect to earn good returns on our capital, and each product must stand on its own. However, we understand volatility and recognize that not all products will earn profits every year. We strive to manage the business so that each product will earn good returns in five-year blocks of time and so that our varied product mix will produce underwriting profits every year. We have learned from the events of 2004 and 2005 and will be a better company as a result of the experience.

We have made several changes to how we write catastrophe-exposed business. We have set higher prices, reduced limits, increased deductibles and taken other steps to better control aggregate catastrophe exposures. As a result, we would expect that if the weather were the same in 2006 as 2005 our results would be much improved, should it get worse, we will remain financially secure and adjust accordingly, and with good weather, our results should be very pleasing.

## 2005 FINANCIAL REVIEW

Operating revenues decreased 3% to $2.2 billion in 2005 as the insurance market became increasingly competitive. Gross written premiums decreased 5% to $2.4 billion due to our sale of Corifrance, exiting lines of business that were not meeting our underwriting profit targets and an increase in competitive pressures in almost all of our markets. Earned premiums decreased 6% to $1.9 billion as a result of the above items and additional reinsurance costs resulting from the 2005 hurricanes.

Our combined ratio for 2005 was 101% compared to 96% in 2004. As mentioned earlier, the 2005 hurricanes are estimated to cost Markel $246 million, or about 12 points of our 2005 combined ratio. For comparison purposes, the 2004 hurricanes cost an estimated $80 million and represented about 4 points of our 2004 combined ratio.

With continued growth in our investment portfolio and rising interest rates, investment income increased 19% to $242 million. Realized gains were $20 million in 2005. Total investment returns were not as strong due to the effects of higher interest rates on the value of our fixed income portfolio and a sideways equity market. Our taxable equivalent total return for the portfolio, after foreign exchange losses, was approximately 1.5%.

Net income for 2005 was $148 million compared to $165 million in 2004. Shareholders' equity and book value per share grew to $1.7 billion and $174 per share, respectively. Compounded annual growth in book value per share was 3% for the year and 11% for the five-year period. We are never happy to report an underwriting loss; however, we were able to withstand unprecedented catastrophic events and grew book value, even if only modestly.

## BUSINESS REVIEW

Sometimes, it is easy to lose sight of the fact that the vast majority of our product lines have little or no catastrophic exposures. In 2005 many of these products produced exceptional results. One of our greatest strengths is a diverse portfolio of over 90 specialty products and, with the exception of our wind-exposed offerings in 2005, virtually every one of our other products met or exceeded our lofty profit expectations.

There is an abundant amount of good news in our operating units and we would like to share a few highlights with you from 2005.

### Excess and Surplus Lines

Our Shand/Evanston unit located in the Chicago suburb of Deerfield, Illinois, had an exceptional year, producing over 30 points of underwriting profit in 2005. This stunning achievement is the result of writing profitable business and continued favorable loss development on business written over the past several years. Mike Rozenberg and his talented team of professionals have a winning combination of superior technology and excellent customer service. Our paperless environment has given us a competitive edge and our service to our broker partners is among the best in the industry. Shand is an excellent example of the safety valve that the Excess and Surplus Lines marketplace plays in the overall insurance industry. Over the last several years, we have seen our claims-made products liability and medical malpractice books of business grow rapidly as the standard market walked away from these two specialty classes.

On the other hand, our disciplined underwriters know when and where to walk away from business as market conditions become less attractive to us and more attractive to others. A great example of this disciplined approach can be seen in their management over time of the physicians product, which forms part of their medical malpractice program. At the very bottom of the soft insurance market in 2000, Shand was only able to write $13.9 million of physicians business that met our profitability goals. The market rapidly improved beginning in 2001 and Shand profitably grew the book to $96.8 million by the end of 2003. However, competition is again on the rise in the physicians market and Shand grudgingly reduced its writings to $66.7 million in 2005. During our 16 years of ownership, Shand's professionals have repeatedly demonstrated the fortitude to walk away from underpriced business. Congratulations to Shand on an extraordinary year.

### Specialty Admitted

In our Specialty Admitted segment, our hats are off to Britt Glisson and his talented team at Markel Insurance Company. Over the past five years, they have grown the top line while increasing the margin of profitability on the bottom line, producing over 20 points of underwriting profit in 2005. This is no small task to accomplish in any market cycle. Markel Insurance Company's success is built on its ability to keep its customers for many years. Over time we have determined that long-term customer relationships are usually our most profitable. Markel Insurance Company's customer retention rate is approximately 81%, and in several of its core lines, we retain over 90% of our customers. In a highly-competitive market, this is an outstanding achievement. Value-added services such as loss control and crisis management assistance combined with attention to service are some of the reasons customers keep coming back.

**London Insurance Market**

While Markel International endured its fair share of hurricane losses in 2005, its professional liability businesses, which include its Retail and Professional Indemnity divisions, continued to perform superbly. The Retail division, using its branch strategy, has proven to be one of the most successful contributors to our results in the U.K., consistently producing underwriting combined ratios in the low 80s. The Retail division's emphasis is on professional indemnity products delivered through independent retail agents. When we began 2005, Markel International had four service offices in the U.K. They were located in the cities of Manchester, Birmingham and Reigate, all reporting into the Retail division's headquarters, located in Leeds, England. We used this anchor in 2005 and expanded with additional offices in Bristol and Cambridge as well as Edinburgh, Scotland. As Steve Carroll, manager of the Retail division says, "all of the pieces of the puzzle are in place!" These three new offices will begin producing profitable results for us in 2006 and we know that we can count on them for many years into the future. The strategy is a straightforward one — being located closer to our ultimate customer gives us the ability to provide superior customer service. This same strategy has been deployed with our new international offices in Madrid, Spain and Toronto, Canada. We are enthusiastic about the future prospects for profitability as Gerry Albanese and his talented team drive our international expansion.

**Other Operating Units**

Even in our operating units that incurred hurricane losses, there is ample good news to share. Essex Insurance Company's contract casualty department continues to turn in stellar results year after year. The profits that have been produced over the past 25 years are nothing short of miraculous.

At our Investors unit, we witnessed early favorable trends from the most recent years in our primary casualty product, an area that has caused us difficulty in the past. In addition, Investors' environmental products continue to grow and meet or exceed underwriting profit expectations.

At Markel Southwest Underwriters, we are starting to see the fruits of six years of operating under the Markel banner. In spite of storm losses in 2005, this unit exceeded our overall profit goals.

At Markel American, our margins increased on our core motorcycle business while premium volume continues to grow.

Markel Re continues to build profitable books of business in small commercial umbrella, casualty facultative reinsurance and our fastest growing product, Specialized Markel Alternative Risk Transfer (SMART).

Our newest unit, Markel Global Marine & Energy, will open its doors for business in the next few months. This specialty array of products will complement those already offered at Markel International and in our U.S. operations.

As you can see, we have much to be proud of in 2005. While our consolidated underwriting results did not meet our high expectations, we have the people and platform in place to produce true Markel-like numbers in 2006.

## INCENTIVE COMPENSATION

Our underwriting culture and success is closely linked to our compensation philosophy and programs. We want our associates to earn reasonable base salaries and benefits, but have the opportunity to earn significant performance incentives based on underwriting profitability, or in the case of the executive team, based on growth in book value per share. To demonstrate what we mean by significant, over the past three years, our incentive compensation payments have averaged over 40% of base salaries. We estimate that incentive compensation payments to Markel associates for 2005 performance will approximate $50 million, including $1.1 million for the executive team.

Top performers receive the biggest checks. Our associates at Shand, Markel Insurance Company and Markel International's retail division, as well as many others, generated substantial underwriting profits in 2005. Unfortunately, your executive team did not do as good a job growing book value per share. As a result, over 30 associates will earn larger cash bonuses than the six members of the executive team. We are delighted for them and we expect to do a better job in 2006.

## INVESTMENTS

Investment activities are an integral component of our business model and are crucial to our long-term growth in shareholders' value. In managing these assets our first task is to protect and preserve the capital we need to conduct our insurance operations. Second, we seek to build and grow capital in the most prudent and productive manner possible.

During 2005, we earned modest investment returns. Fixed income returns were 3.9%. We continue to be committed to very high credit quality fixed income investments and a shorter than normal duration to minimize the impact of higher interest rates. Long-term readers of this report might recognize this phrase. It has been consistent on the credit quality issue forever, and on the interest rate risk issue for the last few years. We are leery of the returns offered on long-dated fixed income investments as we do not think they compensate us for existing and future inflation risks. We are sticking to limited duration fixed income investments. In 2005 rates did rise, especially at the short end of the curve, and bond prices fell modestly. We offset some of these price declines with interest income to produce a positive overall return. We expect to remain short in duration, high in credit quality, and balanced between government, municipal and corporate securities in 2006. If the markets move dramatically in 2006, we will respond accordingly.

In the equity market we had flat performance in 2005 with a total return of (0.3%). This is below our normal expectation of double digit returns from equity investments. Our longer term five- and ten-year records still reflect excellent returns over very challenging investment environments.

We have invested for many years following a four-part thought process to select and manage our equity investments. Namely, we look for profitable businesses with good returns on capital, management teams with equal measures of talent and integrity, reinvestment opportunities and capital discipline, and reasonable prices. Ironically, 2005 was a year in which many of our portfolio companies which meet these tests did not move in price, hence our flat performance. While share prices fluctuate a lot more than underlying share values, the long-term course of share prices is determined by underlying per share earnings. We are confident that our time tested discipline is an excellent process for managing investments as demonstrated by our long-term results. We are optimistic that continued earnings growth in our underlying portfolio of companies will be reflected in higher stock prices and good investment performance over time.

One positive aspect of flat stock prices and better underlying economic performance is that we are getting a better "bang for our buck" as we continue to use the cash flow from our business to purchase more shares at reasonable prices. Additionally, our long-term orientation allows us to achieve tremendous tax and economic efficiency. At year end, the unrealized gains on our equity portfolio stood at $438 million. While we have provided for an ultimate tax liability of $153 million in our financial statements, these taxes will not have to be paid until we sell the investments and realize the gains. Meanwhile 100% of the investment will be growing. This tax deferral, which fits our long-term horizon, adds tremendous and growing value over time to our company. Our long-term horizon is increasingly rare in the investment world and creates a significant advantage for us. Additionally, our costs for managing, trading, and even making mistakes in our portfolio, are minimized by our ability to think about and hold investments for decades rather than for quarterly, or monthly performance.

### Market Review

Our goal in managing equity investments is to earn double digit returns over the long run. This is an absolute rather than relative goal. While our focus is on absolute returns, we acknowledge that relative returns exist as a bogey for alternative choices. Over the long term we have met our absolute return goals and exceeded the S&P 500 benchmark over meaningful time periods. Unfortunately, 2005 was a year in which our returns fell below our absolute goals and underperformed on a relative basis. We tend to own a disproportionate amount of financial service companies which suffered from the previously discussed difficulties in the insurance industry and rising interest rates. We remain long-term believers in the prospective returns of these businesses.

The stars of 2005's financial markets were led by the commodity-oriented businesses of energy and gold as well as certain technology companies as most exemplified by Google. While energy markets clearly moved up dramatically in 2005 and we salute those who profited from those trends, two major factors kept our energy investments at a minimal level in the overall portfolio. First, and most importantly, energy and energy sources, like technology, change over time. For investors, this change is both exciting and dangerous. It is exciting because change creates dramatic positive outcomes for certain companies in the energy markets. It is negative, because the long-term trend in energy and technology pricing is down. This creates a headwind for businesses in those fields and we prefer to avoid investing in companies with decreasing pricing power. Although consumers worldwide benefit from progress and change in these markets, we as investors remain wary about the long-term prospects for these companies and the durability of their profits.

Second, certain aspects of energy pricing are similar to gold prices, where perception and geopolitical events swamp all other factors. We remain investors focused on long-term, durable-compounding businesses with easier to understand franchises or business dynamics. As such we sidestepped the hot energy and gold markets of 2005 and will likely continue to do so in the future. Over long periods of time this approach has proven sound.

Technology stocks, and in particular Google, also rose dramatically in 2005. While these companies continue to delight us as consumers and we enthusiastically applaud the productivity and efficiency gains these companies create for society, the businesses remain volatile and only minimally predictable over time. We focus on consumer-oriented, financial service and distribution businesses because we believe we are better able to make, and are more likely to be successful in, judgments about these kinds of businesses. We are willing to forego the excitement of markets like 2005 in order to be more certain that we're earning good returns over the long term.

**Private Equity and Alternative Investment Activity**

A major area of interest in the investment markets these days is "Alternative Investments." This includes hedge funds, private equity, and various other asset classes that are thought to provide investors with both attractive and non-correlated returns. As Warren Buffett of Berkshire Hathaway noted in a recent talk, investment markets regularly progress through a sequence where they are led by innovators, then imitators, then swarming incompetents. We don't know exactly where "alternative investment" markets are in that progression but we believe they are in the second, if not the third, stage of development. We also believe that the high transaction and ongoing management fees common in this area diminish the long-term returns available to the ultimate owners of the underlying businesses.

After the "swarm" phase, we believe that returns become disappointing, if not dreadful, and opportunities begin to be created as sellers get out and prices drop to more economically attractive levels. We expect this to occur over the next several years and we look forward to participating in these markets as opportunities present themselves. If and when we do participate, we expect to avoid many of the transaction and management fees which detract from long-term value.

To prepare for the opportunities we see developing in these markets over the next five to ten years, and more importantly to participate in promising opportunities, we pursued two private transactions in 2005. While the dollar amounts invested are relatively small at this time, we are optimistic they will lead to additional opportunities. Both of these opportunities meet our four criteria listed above: profitable businesses with good returns on capital, management teams with equal measures of talent and integrity, reinvestment opportunities and capital discipline, and reasonable prices.

In 2005, we made a majority investment in AMF Bakery Systems, a Richmond-based producer of equipment for the baking industry. We knew the principals of the company from long-standing community and personal relationships and we believe the business is durable and profitable with attractive returns on capital. Existing management purchased the remaining portion of the business and we will jointly enjoy the long-term economics of the business.

Additionally, in 2005 we committed to purchase a significant minority interest in First Market Bank in Richmond, in partnership with the Ukrop family. As Richmond readers probably know, the Ukrop family runs a successful and unique grocery business. Their values of integrity, absolutely first-rate customer service, an outstanding workplace environment and community involvement match up with our values perfectly. First Market Bank enjoys co-location and cross-marketing relationships with the Ukrop's grocery chain and we are excited to participate in their continued growth and development.

In both of these instances, we were able to find and negotiate these transactions principal to principal. By making these investments directly rather than through hedge fund or fund structures, we achieved significant cost and return advantages. We believe similar additional opportunities will develop over time and we look forward to expanding this part of our investment portfolio.

**Future Prospects**

We expect our future investment activities to continue in the manner discussed earlier. While the types and forms of investments may change over time our commitment to the principles of preservation and prudent growth of capital and a long-term investment horizon will not change. Our commitment to these principles has produced outstanding long-term results and we believe our adherence to these principles will continue to produce superior long-term investment results in the future.

Finally, we would like to thank our long-term shareholders. We believe that you are some of the premier thinkers in the investment world and are invaluable in your generous source of counsel, ideas and support. We wish to thank you for expanding our horizons with investment thoughts and insights, which help us manage our investment portfolio.

## BALANCE SHEET AND CAPITAL STRENGTH

During 2005, our investment portfolio grew 4% to $6.6 billion, primarily as a result of operating cash flows. At December 31, 2005, there was approximately $671 of portfolio working for each share of common stock.

Operating cash flows declined to $551 million in 2005 from $691 million in 2004 due to the decline in our 2005 premium volume, payments of 2004 and 2005 hurricane losses during the year and commutations.

Reinsurance recoverables increased to $1.9 billion in 2005 from $1.8 billion in 2004. The increase is due to approximately $568 million of reinsurance recoverables related to the 2005 hurricanes. Without hurricane recoveries, our reinsurance recoverables would have decreased to $1.3 billion in 2005. The recoverables related to the hurricanes are almost entirely due from financially strong reinsurers, many of whom provide us with security for amounts they owe us. We expect these balances to be collected promptly as we pay hurricane losses during 2006. Our non-hurricane reinsurance recoverables continued to fall as we have consistently increased our retention of gross written premiums, aggressively collected outstanding balances and commuted with reinsurance companies that are no longer core reinsurance partners.

Loss reserves increased to $5.9 billion in 2005 from $5.5 billion in 2004. Approximately $680 million of this increase was due to the 2005 hurricanes. Our long-stated goal and consistent philosophy is to establish loss reserves that are more likely redundant than deficient. Surprises are almost always bad in the insurance industry and as a result we have long attempted to establish a margin of safety in our loss reserves. This translates into our ultimate goal of establishing loss reserves that we do not have to increase in the future. We believe we accomplished this goal in 2005.

On page 98 of the report you can see our past results in establishing loss reserves. We are pleased to report success in 2005, as prior years' loss reserves developed favorably by $51 million. To be fair, our 2005 success represents the first time we have achieved this lofty goal on a consolidated basis since 1999. Our lack of success in the intervening years was primarily the result of adverse loss reserves development on Markel International legacy business, Investors' general and product liability business and asbestos exposures. Now that we are "back in the black" so to speak, we will work to continue this trend into the future. Of course, the ability to achieve favorable reserve development all starts with our underwriters and their ability to write profitable business.

As a result of our strong capital position, our Board of Directors authorized the repurchase of up to $200 million of our common stock. Our thought at the time was that we would like to minimize dilution from the potential conversion in 2006 of our convertible notes payable. In 2005, prior to the hurricanes, we repurchased 49,400 shares for approximately $16 million. After these events, we did not repurchase any additional shares in 2005; however, in early 2006, we repurchased an additional 129,200 shares for approximately $42 million. The authorization remains in effect and we will exercise sound judgment in considering when, or if, to repurchase shares.

## THE INSURANCE MARKET

During 2005, general underwriting conditions and pricing in the insurance marketplace deteriorated. We believe it is suicidal to chase business as price levels drop below those necessary to earn good returns on capital. As a result, we meet competition where we believe we have appropriate margins of safety and walk away from business that we believe is underpriced. Our flat overall revenues in 2005 reflect our disciplined focus on the bottom line, not the top line.

Increased competition is coming from many sources. The standard insurance markets are again beginning to seek more specialty business (often below standard rates) and new specialty markets are entering the fray. Overall, competition and our free markets are wonderful, but they require that we remain disciplined and focused on the bottom line, not the top line. We have lived through this before and we have produced excellent results despite what turned out to be foolish competition. We fully expect to do so again.

The recent hurricanes cost the insurance industry a significant amount of capital and many are promoting the idea that substantial rate increases are on the horizon for 2006. Clearly in those areas most exposed to future hurricane losses substantial rate increases are necessary. But it is less clear whether or not this "rate talk" will convert into action. We are not optimistic that there will be broad based rate increases. We will act with discipline and financial prudence regardless of what our competitors do and seek to obtain rates which cover the risks and provide appropriate returns to our shareholders.

Most people outside the insurance industry assume that everyone knows what prices are necessary to generate profits. Unfortunately, this is simply not the case. Predicting future losses is a tough, challenging and complicated process without much certainty. Today many in the business are enthusiastic about an expectation that they might successfully increase prices by 100% or in some cases even 200%. What that suggests is that the very same people were selling insurance last year at a 50% or 67% discount. It is unlikely that they were doing so with the expectation of losing large sums of money. In many lines of the insurance business, getting the price right is an iterative process. We learn as we go; we try, try and try again. Fortunately, at Markel, our exceptional underwriters get it right most of the time.

Throughout the history of the insurance industry, financial markets and investment bankers were quick to respond to major industry loss events and create new insurance companies to capitalize on perceived opportunities. While some of the innovators proved successful, most imitators ended up delivering marginal results. The promoters of many of these companies seek quick returns and to sell out before the next event. Most investors in these companies seem to have little interest in the companies' long-term success.

In addition to the new companies, we are surprised and befuddled to see many other companies reporting hurricane losses of 30%, 40% or even more than 50% of their capital who are unapologetically raising new capital to pay the losses. Some are even raising extra capital and promising a new market in which they will somehow perform better than before, and the financial markets are providing that capital eagerly. We are stunned that capital markets are not more skeptical of these promises, but we are getting used to it.

This creates concerns. The first is that there is an acceptance that it is okay for managers of a company to expose too much capital to a single event because the capital markets will always be there. Related to this idea, is the thought that capital in the insurance industry has a short-term orientation. Much of the current capital funding new ventures is coming from hedge funds. In 12 or 24 months they will be looking to move on. If these companies are willing to expose a large part of their capital to losses and investors are looking to make a quick trade, it will be a real challenge to build a strong, sustainable business. The long list of subpar and failed companies in the industry indicates that this model does not work in the long run.

Markel offers a clear contrast to this approach. Our business is run for our long-term owners and not short-term traders. Our strength comes from our corporate culture of discipline, accountability, and integrity. Our 75-year history demonstrates success.

## CLOSING COMMENTS

We had high hopes for our 75th year and fell short of our expectations. Our success is due to our ability to face issues, recognize our problems and fix them. For the five-year period ending December 31, 2005, compound annual growth in book value per share was 11%, far short of our stated goal. Our ten-year and twenty-year results of 16% and 28%, respectively, continued to show excellent returns. We have a strong business, great associates, a wonderful market franchise and a demonstrated ability to build shareholder value.

We are very optimistic about the prospects for 2006 but are even more confident about the ability of our team to deliver results and success over the long term. We want to thank our associates for living and executing the Markel Style and we thank you, our shareholders, for your continued support. We look forward to reporting our progress to you over the coming years.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*President and Chief Operating Officer*

Steven A. Markel
*Vice Chairman*

Paul W. Springman
*Executive Vice President*

Thomas S. Gayner
*Executive Vice President and Chief Investment Officer*

Richard R. Whitt, III
*Senior Vice President and Chief Financial Officer*

*From left to right: Paul W. Springman, Anthony F. Markel, Thomas S. Gayner, Steven A. Markel, Alan I. Kirshner, and Richard R. Whitt, III.*

# 2006 TO OUR BUSINESS PARTNERS

We are pleased to report record underwriting profit, superior investment returns and strong book value growth in 2006, our 20th year as a public company. Celebrating our success is especially rewarding because we have built an incredibly strong company that keeps getting better. A major effort throughout 2006 was to improve the management, pricing and control of our catastrophe exposures. While we believe we've been successful in this effort, we were not tested this year. As a result, our 2006 results include a large dose of good luck as the weather was extremely benign. We are not complaining.

However, good weather does not deserve all the credit for our exceptional 2006 performance. Our associates deserve the real credit as their combined energies produced stunning results. Gross written premiums increased 6% to $2.5 billion. Growth in our investment portfolio and higher interest rates produced net investment income of $271 million, a 12% increase over 2005. Realized investment gains were $64 million. Earned premiums were up 13% to $2.2 billion in 2006; and our underwriting results improved dramatically, producing a combined ratio of 87%. Net income was a record $393 million, more than double our previous record year. As a result of all this good news, book value per share increased 32% to approximately $230 per share.

In this letter, we will discuss our financial results, including our underwriting and investing operations. However, throughout this year's letter, we also want to focus on principles that underlie both our daily underwriting and investment decisions and are integral components of the Markel Style. At Markel, underwriting and investing are working from the same blueprint. The principles that support profitable underwriting are the same ones that lead us to superior investment returns and, in turn, help us build shareholder value. These important principles are: maintaining a long-term time horizon, discipline and continuous learning.

## TWENTY-YEAR PERSPECTIVE

While we are delighted to discuss 2006, we recognize that in any one year fortuitous timing (good luck) influences our results just as much as, if not more than, our fundamental business discipline. Over longer time horizons, however, the effect of timing fades away. It is superseded by sound business principles and skilled application which becomes evident only with the passage of time. These facts help, in part, to explain why we focus on long-term measures at Markel. Anyone, including us, can get lucky in the short-term. However, over 10, 20 or more years, only companies with skill and discipline can consistently produce value for their shareholders.

The chart at the bottom of these pages shows some key numbers for Markel's first 20 years as a public company.

| *(in millions, except per share data)* | **2006** | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 |
|---|---|---|---|---|---|---|---|---|---|
| Gross written premiums | **$ 2,536** | 2,401 | 2,518 | 2,572 | 2,218 | 1,774 | 1,132 | 595 | 437 |
| Combined ratio | **87%** | 101% | 96% | 99% | 103% | 124% | 114% | 101% | 98% |
| Investment portfolio | **$ 7,535** | 6,588 | 6,317 | 5,350 | 4,314 | 3,591 | 3,136 | 1,625 | 1,483 |
| Portfolio per share | **$753.98** | 672.34 | 641.49 | 543.31 | 438.79 | 365.70 | 427.79 | 290.69 | 268.49 |
| Shareholders' equity | **$ 2,296** | 1,705 | 1,657 | 1,382 | 1,159 | 1,085 | 752 | 383 | 425 |
| Book value per share | **$229.78** | 174.04 | 168.22 | 140.38 | 117.89 | 110.50 | 102.63 | 68.59 | 77.02 |
| 5-Year CAGR in book value per share[1] | **16%** | 11% | 20% | 13% | 13% | 18% | 21% | 22% | 23% |

[1] CAGR—compound annual growth rate

For the 20 years, in every important category, we posted compound growth rates of higher than 20%, albeit from very modest beginnings. The measures on this chart reflect our core goals: underwriting profits and growth in book value per share.

Over the 20-year period, we missed our underwriting target six times on an annual basis. These shortfalls occurred due to acquisitions where we purchased companies in need of improvement, the events of September 11, 2001 and the hurricanes of 2005. Despite the periods of annual shortfalls, we are very proud of our underwriting results over time.

The 2006 year was also fantastic for our investment portfolio. We enjoyed a measure of good luck this year as we earned 25.9% on our equity portfolio and 5.2% on our fixed income portfolio for a taxable equivalent total return of 11.2%. Given the inherent investment leverage in our insurance operations, these levels of investment returns more than support our long-term goal of high returns on Markel's shareholders' equity.

More important than the returns of any one year though are the returns created over years and decades. Over long-term periods, when time and our investment discipline begin to outweigh good luck, our results have been wonderful as well. For the last five years we earned 13.9% on our equity investments and for the last ten years we earned 14.3%. By comparison, the S&P 500 over these time frames returned 6.2% and 8.4%, respectively. This is a dramatic out performance over meaningful periods of time.

Over the course of 20 years, you will notice annual volatility in growth in book value per share. As we have a long-term time horizon and focus our energies on economic earnings, sometimes to the detriment of quarterly and annual reported earnings, we have always been willing to accept some short-term volatility in book value growth. However, when examined over longer periods of time, volatility diminishes and the pattern of performance emerges. This can be seen over the past five and 20 years, as book value per share grew at a compound annual growth rate of 16% and 23%, respectively.

## LONG-TERM TIME HORIZONS

The long-term view is critical to both our underwriting and investment decisions. It can be seen in our approach to investments, acquisitions, underwriting, organic expansion efforts and private equity opportunities.

Twenty years ago, when Markel went public, the investment portfolio totaled $31 million and shareholders' equity totaled $15 million or $3.42 per share. Over the last 20 years, investments grew to $7.5 billion and shareholders' equity grew to $2.3 billion, or approximately $230 per share. These represent compound annual growth rates of 32% and 23%, respectively.

| 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 | 1990 | 1989 | 1988 | 1987 | 1986 | 20-Year CAGR[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 423 | 414 | 402 | 349 | 313 | 304 | 406 | 412 | 44 | 43 | 32 | 35 | 24% |
| 99% | 100% | 99% | 97% | 97% | 97% | 106% | 81% | 78% | 84% | 85% | 78% | — |
| 1,410 | 1,142 | 927 | 622 | 609 | 457 | 436 | 411 | 79 | 59 | 46 | 31 | 32% |
| 257.51 | 209.20 | 170.95 | 115.45 | 112.55 | 84.64 | 81.77 | 77.27 | 14.54 | 11.35 | 10.67 | 7.07 | 26% |
| 357 | 268 | 213 | 139 | 151 | 109 | 83 | 55 | 60 | 45 | 20 | 15 | 29% |
| 65.18 | 49.16 | 39.37 | 25.71 | 27.83 | 20.24 | 15.59 | 10.27 | 11.69 | 9.22 | 4.66 | 3.42 | 23% |
| 26% | 26% | 31% | 17% | 25% | 34% | 35% | — | — | — | — | — | — |

In 1986, it would have been impossible to forecast the real estate troubles of the early 1990's and the collapse of the savings and loan system in our country. It would have been impossible to foresee the rise of the internet, the weakening and strengthening and weakening again of the dollar. It would have been impossible to foresee the swings in energy prices. It would have been impossible to foresee the nature of the geopolitical struggles we've seen in the Middle East. It would have been impossible to foresee the terrorist attacks of September 11, 2001. All of these things affected the world's economies temporarily, but no one could forecast them, or their effects, with any consistency.

At Markel, we didn't forecast them, and we didn't need to, in order to create excellent long-term returns for our shareholders. We simply took the capital we had and used it to the best of our abilities in the insurance and investment arenas following sound and proven business disciplines. We learned each year and continued to develop our knowledge in insurance, investments and acquisitions. The long-term results speak for themselves. Equally important, this approach suggests that our culture, systems, learning, skills and decision making should remain effective in our effort to earn superior returns on capital in the future.

After our purchase of the Terra Nova Group in the spring of 2000, we embarked on a methodical and deliberate process of dealing with the legacy issues that we inherited, while simultaneously re-underwriting certain segments of the portfolio that were unprofitable. In the short term, this was a painful exercise for Markel's associates and shareholders as our results fell short of our standards. However, we believed that by sticking with our discipline and instilling the Markel Style, Markel International's long-term prospects were bright. The results have steadily improved and in 2006 Markel International began to report underwriting profits. We are now fully focused on the future and are implementing initiatives to leverage our London presence and Lloyd's platform for international expansion. Markel International is now contributing to growth in shareholder value because we focused from the beginning on long-term, rather than short-term, goals.

Woody Allen once opined in a movie that "90% of life is just showing up." That may be true, but showing up on time is even more important. Before the horrible storm season of 2005 brought us Katrina, Rita and Wilma, we had made the decision to geographically diversify our off-shore energy business. When those events occurred, the losses in our marine and energy division, though painful, were significantly less on a relative basis than the rest of the market. As a result, we were able to expand those products in 2006 and are strategically positioned to do the same in 2007. Was there an element of luck involved in our decision? The short answer is yes. However, we constantly monitor and adjust our underwriting and pricing strategies, and luck can sometimes be confused with doing the right things over and over again.

Last year in our letter we discussed opening five new Markel International branch offices. They are located in Bristol and Cambridge, England; Edinburgh, Scotland; Madrid, Spain; and Toronto, Canada. We are pleased to report that all five are up and running and produced business that added to our bottom line this past year. We are extremely pleased with all five branches; but it will be some time before they have a major impact on results. We are patient and take a very long-term view in regards to expansion.

Our recent entry into private equity also represents a good example of our long-term view. While 2006 is only the first full year, we are extremely pleased with our private equity investments to date. AMF Bakery Systems and First Market Bank enjoyed solid years of profitability and should enjoy increased earnings going forward. More importantly, these deals, which we did directly with the principals rather than through intermediaries or fund structures, point the way towards additional investment potential over time.

Private equity and hedge funds are currently the white hot areas of the investment world. We expect that over the next several years many investors will become disenchanted with their returns due to the overwhelming headlong rush into this area by so many pension and endowment funds. We think that the high fee structures associated with this form of institutional investment and the short-term nature with which so many of the investee companies are being run will ultimately produce disappointing results. Following disappointing results, we expect many investors will seek to sell rather than buy private equity. Our measured approach to date has been to invest directly in businesses, support management teams with a long-term return on capital focus, and build the skills and relationships that should allow us to participate in this area in a more meaningful way as opportunities develop over the next several years.

## DISCIPLINE

Whether it is our underwriting or investing operations, we believe that our discipline over long periods of time is what distinguishes us from our competitors. Many of our associates have long periods of service with Markel. At December 31, 2006, a quarter of our 1,897 associates have been with us for over ten years. These associates have experienced the hard and soft insurance markets and bull and bear investment markets. They have learned from their successes and, more importantly, their failures. They have embraced the Markel Style as a way to conduct business. These Markel veterans ensure that our underwriting and investing disciplines are consistently applied and are passed on to our newer associates.

At Markel, underwriting discipline represents both a philosophy and a process. Our philosophy is to work to achieve consistent underwriting profits in all products in all insurance market conditions. The process by which we achieve underwriting profits can be slightly different by underwriting unit but generally includes finding the answers to four questions: Can we assess the risk we are taking? Can we design the appropriate coverage for our client? Can we price the risk to earn an underwriting profit? Can we assess trends that may increase our risk in the future?

One of our first insurance products, the casualty product at Essex Insurance Company, is an excellent example of this discipline. We have been underwriting this product for 26 years with 10 or more points of underwriting margin the norm rather than the exception. Over the years, this product has become one of our largest as well as one of the most profitable. Much of this business is underwritten in the field by managing general agents who work within tightly defined "boxes" of authority that are set by Essex's underwriters. Average premiums per policy are less than $5,000 and typical accounts might be small artisan contractors and habitational risks. Many excess and surplus lines companies offer similar products but few have the underwriting results that Essex has enjoyed for decades. One of our most important daily disciplines is that each of the policies underwritten and issued by our agent partners in the field is re-underwritten and re-priced by an Essex underwriter prior to the policy receiving final approval and processing. This second set of eyes has proven invaluable; this extra step of discipline is directly responsible for a big portion of our underwriting profits.

When we first invested in the Shand/Evanston group in the late 1980's, their specialty offerings included a $50 million book of products liability business. As market conditions softened in the early 1990's and rates remained at depressed levels for almost a decade, sticking to our underwriting discipline required that we walk away from premium volume in this line. Annual premium volume ultimately fell below $10 million. Our underwriters worked side by side with our actuaries to continually define and understand when and where it was necessary to walk away from marginally priced business. Many of these underwriters were redeployed into other product areas that offered better opportunity and some even moved into other areas at the company outside of underwriting. However, when market conditions changed in late 2001 and pricing continued to harden during the following few years, Shand was there with market solutions and the necessary people and expertise to provide the customer service our clients demanded. For the last several years, Shand has written products liability premium volume that is a multiple of those levels from the late 1980's. While premium volume has necessarily changed with market conditions, Shand has generated significant underwriting profit margins over the years through consistent application of their underwriting discipline.

This same discipline is embodied in our investment philosophy. To review the catechism of our four part equity investment philosophy, we seek to invest: 1) in common equity of profitable businesses with good returns on capital, 2) with honest and talented management teams, 3) with reinvestment opportunities and capital discipline, 4) at fair prices. The north star provided by this time-tested discipline creates a guide to constant learning and improvement.

It is important to engrain this discipline in good years because we will need to remember it and stick to it during bad years. At some time in the future, we will have less than wonderful news to report from a single year's worth of investing activities. All good investors suffer years of underperformance. In those times, it is easy to lose your moorings and drift into different styles and methods of investing since whatever discipline or approach you were using didn't work out so well over the most recent twelve-month period.

If your basic discipline is sound, drifting away from it is a big mistake. This mistake is common among both amateur and professional investors. Most people simply cannot take the psychological pain of underperforming for very long. The inherent uncertainty in investing and thinking about the unknowable future, causes people to embrace the practices of what others are doing currently. Human nature seeks comfort in crowds rather than the relative isolation of remaining independent in thoughts and actions.

Our investment discipline also tends to create excellent tax efficiency over time. The items we focus on, such as basic profitability and good reinvestment attributes, are typically long-term attributes of a company. As such, we tend to buy and hold our equity investments for significantly longer periods of time than most institutional money managers. In fact, our ideal investment is one that we can own forever. The result is that we defer the payment of taxes into the future rather than paying them each and every year as a short-term trader would.

You can see this aspect of our investment philosophy on our balance sheet. As of December 31, 2006, we showed unrealized gains on our investment portfolio of $712 million. Against this gain, we showed a deferred tax bill of $249 million, as we have provided for the payment of our capital gains taxes someday when we sell the appreciated securities. In the meantime, that full unrealized gain is invested and earning a return for Markel shareholders. If we were shorter term oriented and chose to sell our securities due to a forecast of higher interest rates, unfavorable foreign exchange rates, geopolitical circumstances or weather patterns then we would have $249 million less to invest. This difference of having unrealized rather than realized gains has allowed pre-tax compounding to occur in the investment portfolio that would not have been possible without a long-term focused discipline.

## CONTINUOUS LEARNING

Every underwriter in our company has a story about insurance risks that didn't work out. Each of them knows the importance of continually learning from these experiences in order to make better decisions the next time. While this is basic to running an insurance business, or any other business, the concept often seems to get lost. Fortunately, we work hard to keep this simple focus intact in both underwriting and investing at Markel. We concentrate on items we can control and we constantly seek to learn from and improve on the experiences of each year.

Continuous learning is critical to an organization such as Markel that underwrites and markets complex specialty products. Sometimes these learning experiences can be expensive as was demonstrated with the 2005 hurricanes (Katrina, Rita and Wilma). As of the end of 2006, we have incurred $301 million of underwriting losses from these storms.

During the fall of 2005 and throughout 2006, we have worked to learn from last year's experience. We have formed a central catastrophe exposure management team and have developed additional tools to monitor our coastal property and earthquake exposures. We have set insured value limits on the amount of business our underwriting units can write in catastrophe prone areas. We have increased our pricing and refined our coverage. We have established plans and procedures that will be put into action when the next major catastrophe occurs and we have geographically spread our catastrophe exposed business so that we can purchase less reinsurance in the future.

We believe that the lessons learned from the 2005 storms have helped us better manage our catastrophe exposure. While we were fortunate to have benign hurricane activity in 2006, we know that it is only a matter of time before we experience the next bad hurricane season. We also recognize that applying learning to underwriting is an iterative process.

While hurricane losses are an example of an expensive lesson, our environmental products at Markel Underwriting Managers are excellent examples of continuous learning. Several of our senior associates in this division have previous training as environmental consultants and as environmental engineers. This added level of expertise helps us better evaluate environmental assessments, environmental inspections and risks in general. This training has also enhanced our credibility with producers and clients and has allowed us to build this product over the last five or six years into a very significant portion of our writings in Red Bank, New Jersey.

Some of the best opportunities for learning come from listening. Listening may be one of the things that we do best. Most of our underwriters are charged with managing broker and client relations. It is not uncommon for our underwriters to spend up to 20% of their time on the road visiting and working with our clients in their offices. One of the sayings that we have at Markel is that while modern communication is great, nothing replaces eyeball to eyeball contact. This is particularly important in a relationship driven business like ours.

Having been in the insurance business for a long time has made us a good listener when it comes to adding extra service above and beyond the contract. At Markel Insurance Company, we have been market leaders in our camp and youth recreational business for almost two decades. One value added service we offer, that is seldom provided by our competitors, is our 24-hour response capability in case of emergency or catastrophe. Given the large amount of camp business that we write, we expect to receive claims during the camp season involving serious injury. These are devastating events for all involved. When these events occur, we provide our insureds with grief counselors, public relations advice and expert defense protection.

In our excess and surplus lines units, a high percentage of our policy forms are manuscripted, or tailored, to fit individual insureds' needs. It doesn't matter if we are helping an amusement park with coverage for a railroad, a chiropractor who needs a special malpractice rider or an asbestos abatement contractor who needs a knowledgeable environmental underwriter. Our people listen first, and then solve problems.

We also believe that our time tested and proven investment philosophy increases the odds of learning and replicating good results into the future. Recently Bill Miller, one of the most successful money managers in the last 20 years, made a comment that speaks to this point. He noted that an individual security oriented, value based discipline differs meaningfully from an investment approach based on the forecasting of events or circumstances. The important difference between the two is that good forecasting doesn't seem to lend itself to future success in accurate forecasting. By contrast a value based approach of working on business fundamentals such as understanding the reasons for returns on capital, management skill and integrity, reinvestment opportunities, and valuation, seems to offer better skills and results with longer practice.

As an example, suppose you base your investment actions on forecasts (fortune telling) regarding interest rates, oil prices, foreign exchange rates, new technology, the frequency of hurricanes, geopolitical factors or any other of the many macroeconomic factors that affect markets in the short term. Suppose you were right and you made some investment decisions which worked out well due to your correct forecast. What did you learn in that process that will make you equally or better skilled at making forecasts for next year?

Peter Lynch, the famed manager of the Fidelity Magellan fund, once joked that if any economist could predict interest rates correctly twice in a row they would not need to seek gainful employment. The fact that thousands of economists still toil away every day in finance, industry, government and academia ought to tell us something about the ability to make forecasts. It simply cannot be done reliably. Miller suggests that this is mainly because forecasting is not an activity in which one can learn from mistakes.

By contrast, our underwriting and investment disciplines allow us to learn from our inevitable mistakes and get better as time goes by.

When an underwriting decision does not work out, we ask ourselves why. Did we misunderstand the risk? Did we not appropriately build our coverage form? Did we under-price the risk? Did we overlook adverse claims trends?

When an investment doesn't work out, we go back to the four parts of our investment philosophy. Did the business or industry become less profitable due to new technology or competitive factors? Did the management team prove itself to be dishonorable or ineffective? Did capital get allocated to lower return projects or bad acquisitions? Was the price we paid for the stock just too high to allow us to earn a return?

In both underwriting and investing, answering all of these questions in an intellectually honest way allows us to make better judgments when faced with the task of evaluating today's and tomorrow's opportunities. Our investment and underwriting disciplines and the logical questions they suggest create a learning environment which increases our skills and odds of success for the future.

In this discussion, we largely focused on learning from our mistakes. Fortunately, we also have many successes from which we learn. When things go right, we work to apply these lessons on success to other aspects of our business. In both underwriting and investing, appreciating these lessons helps us capitalize on our successes and minimize our mistakes. To borrow an old saying, we want to water the flowers and pull the weeds.

## 2006 FINANCIAL REVIEW

Gross written premiums increased 6% to $2.5 billion as the result of higher premium rates in catastrophe-exposed property lines and growth in new product areas. With the exception of large rate increases on catastrophe-exposed business, rates were generally flat or down slightly compared to 2005. Earned premiums increased 13% to $2.2 billion as a result of higher gross written premiums and higher net retentions of gross written premiums (net retentions of 87% in 2006 compared to 82% in 2005, when our net retentions were impacted by reinsurance reinstatement premiums on the 2005 hurricanes).

Our combined ratio for 2006 was 87% compared to 101% in 2005. The combined ratio for 2006 included $55 million, or 3 points, of losses related to the 2005 hurricanes. The 2005 combined ratio included $246 million, or 12 points, of 2005 hurricane losses. In addition to the favorable impact of the benign hurricane season this year, the improved combined ratio for 2006 was due to an increase in favorable prior years' loss development, primarily in our Shand Professional/Products Liability unit and significant improvement in the results of Markel International (100% combined ratio in 2006 compared to 126% combined ratio in 2005).

Net investment income increased 12% to $271 million. The increase in 2006 was due to higher investment yields and growth in the investment portfolio as a result of $512 million of operating cash flows. Realized gains were $64 million for 2006. Investment returns were outstanding as our taxable equivalent total return for the portfolio was 11.2%.

Net income for 2006 was $393 million compared to $148 million in 2005. Shareholders' equity and book value per share grew to $2.3 billion and $230 per share, respectively. Compound annual growth in book value per share was 32% for the year and 16% for the five-year period.

## BALANCE SHEET AND CAPITAL STRENGTH

Operating cash flow in 2006 was a strong $512 million. Premium volume growth and collections of reinsurance balances more than offset increased claims payments related to the 2005 hurricanes.

Our investment portfolio grew by 14% to $7.5 billion in 2006. At year end, the portfolio represented approximately $754 per share of common stock.

During 2006, our already strong balance sheet improved even further. Operating leverage improved as we reduced reinsurance recoveries by approximately $550 million to $1.4 billion by collecting balances due, retaining more of the business we write and successfully completing several commutations of legacy reinsurance balances. We continue to closely monitor the quality of our reinsurers and maintain significant collateral to support these balances. This is an area of increasing strength on our balance sheet.

In August, we issued $150 million of 7.50% senior notes due in 40 years with a five-year par call. We don't have any talent predicting future interest rates, so the call gives us the option to prepay or refinance this debt. Financial leverage declined and our capital structure was simplified as we forced conversion of our convertible notes during 2006 and retired our junior subordinated debentures in January 2007. Even without taking the latter transaction into account, our debt to total capital ratio at year end was 27%.

As a guideline, we believe that funding our business with roughly one-third debt and two-thirds equity represents a good balance. We think in terms of 25% to 35% as "roughly" one-third. We had slightly more debt than "average" over the past few years, so it is okay to have slightly less than "average" today. Having additional borrowing capacity will allow us to respond quickly when future opportunities arise.

We also repurchased approximately 140,000 shares of our stock for approximately $46 million during 2006. We believed that the $328 per share paid represented a good value.

The net effect of all of this is that our balance sheet is strong and getting stronger. We are particularly proud of our financial strength and the integrity of our balance sheet.

## GROWTH AND OUR MODEL FOR PROFIT

Consistent underwriting profits, superior investment returns and managing our capital create growth in book value per share for our shareholders. A great and common danger in the insurance business is to seek premium growth at the expense of underwriting profits. In the short run, it is easy to sell the cheapest price and grow at the expense of underwriting discipline. In the long run, this always leads to disaster. By continuously improving and getting better at serving our customers and solving their insurance problems we can both grow and achieve good underwriting results. In fact, our record demonstrates precisely this ability.

Over the last 20 years, we've grown both organically and through acquisitions. Two of our acquisitions, one in 1990 and the second in 2000, virtually doubled the size of our company. In both of these cases and in other smaller transactions, we purchased companies in need of repair. These acquisitions required reorganization to focus on underwriting profits along with the Markel culture. The immediate results often included short-term volume reductions, followed in all cases by profitable growth.

While the insurance industry as a whole is very competitive and cyclical, individual products and markets within the industry often show different characteristics. Profitable growth potential exists when it is based on innovation, creativity, customer service and problem solving. As niche underwriters this is what we do. Opportunities always exist. However, these opportunities do not appear in smooth and exact intervals. There will always be periods of ups and downs as with many other aspects of this business. The key, as with most other things, is patience, discipline and constant focus on long-term results.

While we do not force growth at Markel, growth is important and desirable for several reasons, as long as it is accompanied by underwriting profits. First and foremost, we continue to build our capital and we desire to reinvest it in our business where we believe we can earn high rates of return. We're still a fairly small company in a very large industry, so plenty of growth opportunity exists. Meeting the needs of our clients is also important. As they grow and face new risks, we want to be there to solve their risk and insurance problems. Finally, we want to continue to provide intellectual challenges and development opportunities for our associates. All of these objectives are more easily accomplished when we grow as an organization.

To continue to grow in the future, we will increasingly emphasize continuous learning, new ideas, better ways of meeting customer needs, and other opportunities to build our business. We cannot let our high underwriting standards become an artificial excuse for us not to grow. We cannot let our success lead to complacency. We can, and expect that we will, both grow AND earn solid underwriting results.

## LOSS RESERVE PHILOSOPHY

For decades, we've maintained a philosophy of attempting to establish loss reserves at levels which are more likely to be redundant than deficient. We also refer to this philosophy as attempting to establish a margin of safety. It's impossible to set loss reserves perfectly since they represent an estimate about the future outcome of unknown events. Given this uncertainty, we do our best to understand what drives these outcomes, monitor these drivers closely and try to be conservative. We attempt to create a margin of safety so that loss reserves will ultimately prove adequate.

The net unpaid losses and loss adjustment expenses at the end of 2006 totaled $4.3 billion. About 75% of this number is for losses and the remaining 25% for expected loss adjustment expenses. Less than half of this number (about 40%) is related to claims which have already been reported while about 60% is for claims which have not yet been reported even though the losses have occurred. In insurance jargon, this is called IBNR which stands for "incurred but not reported." Unpaid losses from the 2006 accident year are estimated to be $1.0 billion. Of this amount, only 19% are estimates for specific events that we know about today. In many cases, it can take years before an insured knows of, and reports, a loss to us.

Reserves are established for each product and for each accident year. New products and the most recent accident years contain the highest degree of uncertainty. New business is also more unpredictable than renewal business. As each accident year matures, we become more confident in our estimate of the final outcome.

We review our business each quarter using the best information available to estimate our future losses. For the most recent accident years, we base estimates largely on our historic experience and current business plans, along with a healthy dose of skepticism. We analyze the pricing trends and changes in underwriting approaches, the impact of inflation and changes in the legal environment. All of these items require significant judgment and adverse outcomes are possible. We want the reserves to include a margin of safety so that they will ultimately prove adequate. As the accident year matures, the reserves are increasingly based upon actual claims experience and estimates of the ultimate cost of specific claims. If the business progresses as we would hope, any conservatism or redundancy established in the earlier period will be released as the years go by and the actual results emerge.

While we have consistently tried to maintain a margin of safety in our reserves, our experience shows that we have not always been successful. In most years our reserves have proven to be more than adequate; however, we have had some surprises, and surprises are almost always bad in insurance.

Culturally, we emphasize the importance of dealing with bad news quickly. We tend to be a little slower in recognizing good news. Fortunately, we also find examples where our conservatism results in reserves being released. In the period 2000 to 2003 we increased our business in the specialty physicians' product from $14 million to almost $100 million. While pricing was strong and much of this business was first year claims made business, we were very cautious in estimating the ultimate claims costs. New business and fast growth often create problems. Fortunately, this business proved to be even better than our best expectations. In the past few years we have recognized about $75 million in reserve redundancies from this product and, if the current trends continue, there could be a bit more to come.

Consistent application of our reserving philosophy is more important to us than reported earnings. During periods of high growth, or after acquisitions, reported earnings suffer as we establish an appropriate margin of safety. In more normal periods, redundancies established in earlier periods will be released as those accident years mature. At the same time, the current accident year margin of safety is established at conservative levels. When surprises occur, they are accounted for and reported promptly. While the annual impact on the income statement will vary, we expect the loss reserves on the balance sheet to maintain a consistent margin of safety.

Converting this philosophy into practice is also not always simple. We have about 100 different products, each of which has many unique characteristics. Loss reserving starts with historical reviews, which in some of our products can be limited by lack of data. It involves judgments about current underwriting and pricing standards, expected loss frequency and severity, inflation, the legal environment, currency values and other trends.

The reserving process takes advantage of actuarial science using the principles of probability and statistics. Obviously all of the data points are in the past, yet we are trying to forecast the future. Many estimates and assumptions must be made and small variations in these can have a material impact. So while the systems and computers might be very robust, they cannot replace good judgment.

The most important aspects of our past successes and future prospects are that we approach issues and potential problems conservatively and with intellectual honesty. Our philosophy, principles and goals remain clear and guide us as we try to use good judgment in making daily decisions.

We encourage you to read Critical Accounting Estimates beginning on page 79 where we discuss our loss reserving process and philosophy in more detail.

## BOARD APPOINTMENT

We are pleased to have added Lemuel E. Lewis to our board of directors effective February 22, 2007. Lem recently retired from Landmark Communications, Inc., a media holding company headquartered in Norfolk, Virginia, where he served as Executive Vice President and Chief Financial Officer. Lem remains a member of Landmark's board and also serves on the board of the Federal Reserve Bank of Richmond. We are excited that Lem has chosen to join our board. We look forward to having his counsel and the benefit of his experience. Lem will stand for election along with the other members of our board of directors at our 2007 Annual Shareholders' meeting on May 14, 2007.

## CLOSING COMMENTS

Our first 20 years as a public company have been exciting and prosperous; 2006 was a great year and we are optimistic for the future.

This success is, in large part, due to our commitment to the Markel Style and a focus on maintaining a long-term time horizon, discipline and continuous learning. Like any business, we're here to make money. But more than that, we want to build a successful and sustainable organization that can continue to grow, serve its clients well, provide opportunities for its associates and generate financial success for its shareholders for decades and generations to come.

Another integral element to the way we do business is a sound incentive compensation system. Since our earliest days as a public company, management has always worked to put shareholders first. Management compensation at Markel has always been based on the idea that base salaries should be reasonable—but that meaningful incentives should be available when we achieve our lofty goals.

We believe in employee share ownership, but we do not believe that stock options are a good way to create it. Being "given" an option is simply not the same as buying stock. Under our incentive system, when Markel associates deliver exceptional results for our shareholders in the form of underwriting profits or growth in book value, they earn meaningful bonuses. For some of our senior executives, we pay part of their bonuses in restricted stock to tie their interests even more closely to those of our shareholders. For all associates, we have implemented incentives to buy Markel stock so they can choose to participate as owners in a sound and successful business.

These philosophies come together to create a virtuous cycle where success breeds success. Our ultimate goal at Markel is to achieve continued success for all our stakeholders.

We thank our associates, our shareholders and our clients for being part of our success.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*President and Chief Operating Officer*

Steven A. Markel
*Vice Chairman*

Paul W. Springman
*Executive Vice President*

Thomas S. Gayner
*Executive Vice President and Chief Investment Officer*

Richard R. Whitt, III
*Senior Vice President and Chief Financial Officer*

*From left to right: Paul W. Springman, Anthony F. Markel, Thomas S. Gayner, Steven A. Markel, Alan I. Kirshner, and Richard R. Whitt, III.*

# 2007 TO OUR BUSINESS PARTNERS

We are pleased to share with you our 2007 report. The year was very successful on a number of fronts, as we continued to produce excellent financial returns and build the enduring strength of our organization. We benefited from another quiet year on the weather front (no pun intended), and our underwriters maintained their discipline in an increasingly competitive and undisciplined insurance market. We avoided most of the land mines in the financial markets and were pleased with our investment results. Together, our underwriting and investment efforts resulted in net income of $406 million, or $40.64 per share, and growth in book value per share of 15%, to $265.26 per share. The five-year compound annual growth rate in book value per share was 18%.

During the past year, the property and casualty insurance market continued to become more competitive. As we have enjoyed a recent lack of severe weather, some property competitors are pricing risks at what we believe are unrealistic levels. Recent profitable underwriting results in casualty lines have also led to increased pricing pressure. Strong financial returns and new capital raised over the past few years have produced excess market capacity. Based on the most recent industry data, the U.S. property and casualty insurance industry should finish 2007 with approximately $540 billion of capital and $450 billion of annual premiums. This is the lowest underwriting leverage ratio since the low point of the last soft market. In addition, these capital numbers do not include offshore capital in markets like Bermuda and London that is also competing in the U.S. marketplace. While this example only addresses the U.S. market, the same dynamics are occurring in the worldwide insurance market. As a result, the industry has too much capital and, therefore, increased competition.

For Markel, this environment calls for caution. During 2007, our gross written premiums totaled $2.4 billion, 7% lower than 2006. Clearly, we would prefer to grow; however, our focus has always been, and will continue to be, producing profitable underwriting margins. We are pleased to report that 2007 underwriting profits totaled $264 million with a combined ratio of 88%. Growth in our investment

| *(in millions, except per share data)* | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 |
|---|---|---|---|---|---|---|---|---|---|
| Gross written premiums | $ 2,359 | 2,536 | 2,401 | 2,518 | 2,572 | 2,218 | 1,774 | 1,132 | 595 |
| Combined ratio | 88% | 87% | 101% | 96% | 99% | 103% | 124% | 114% | 101% |
| Investment portfolio | $ 7,788 | 7,535 | 6,588 | 6,317 | 5,350 | 4,314 | 3,591 | 3,136 | 1,625 |
| Portfolio per share | $782.18 | 753.98 | 672.34 | 641.49 | 543.31 | 438.79 | 365.70 | 427.79 | 290.69 |
| Shareholders' equity | $ 2,641 | 2,296 | 1,705 | 1,657 | 1,382 | 1,159 | 1,085 | 752 | 383 |
| Book value per share | $265.26 | 229.78 | 174.04 | 168.22 | 140.38 | 117.89 | 110.50 | 102.63 | 68.59 |
| 5-Year CAGR in book value per share[1] | 18% | 16% | 11% | 20% | 13% | 13% | 18% | 21% | 22% |

[1] CAGR—compound annual growth rate

portfolio and higher interest rates produced net investment income of $306 million, a 13% increase over 2006. Net income was $406 million, another record. Total comprehensive income was $337 million with shareholders' equity increasing to $2.6 billion, or $265.26 per share.

## TWENTY-YEAR PERSPECTIVE

We present the 20-year table to remind you, and us, of the importance of maintaining a long-term perspective. While year-to-year volatility does exist, we have enjoyed compound annual growth rates in excess of twenty percent for all categories over the 20-year period. It is interesting to note that gross written premiums over the past five years have barely increased, but, during the same period, we have successfully compounded book value per share at 18%. We are not complacent about our recent lack of premium growth, but the strength of our financial performance in its absence demonstrates the importance of consistent underwriting profits and superior investment returns as the drivers of our success. While premium volume growth over the long term is very important, the year-to-year change bears very little relationship to our bottom line results. We will therefore always seek opportunities for growth, but never at the expense of profitable underwriting.

Due to our focus on underwriting profits over premium growth, we have increased shareholders' equity at a faster rate than our investment portfolio in recent years. At the end of 2007, the investment portfolio was $7.8 billion, about 75% larger than five years ago. During the same time period, shareholders' equity more than doubled to $2.6 billion. As a result, our investment leverage (investment portfolio divided by shareholders' equity) has declined from just under 4 to 1 five years ago to just under 3 to 1 today. As our investment leverage declines, underwriting profits become even more important in driving superior total returns. At the same time, the lower financial leverage allows for a larger allocation to our equity portfolio to

| 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 | 1990 | 1989 | 1988 | 1987 | 20-Year CAGR[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 437 | 423 | 414 | 402 | 349 | 313 | 304 | 406 | 412 | 44 | 43 | 32 | 24% |
| 98% | 99% | 100% | 99% | 97% | 97% | 97% | 106% | 81% | 78% | 84% | 85% | — |
| 1,483 | 1,410 | 1,142 | 927 | 622 | 609 | 457 | 436 | 411 | 79 | 59 | 46 | 29% |
| 268.49 | 257.51 | 209.20 | 170.95 | 115.45 | 112.55 | 84.64 | 81.77 | 77.27 | 14.54 | 11.35 | 10.67 | 24% |
| 425 | 357 | 268 | 213 | 139 | 151 | 109 | 83 | 55 | 60 | 45 | 20 | 28% |
| 77.02 | 65.18 | 49.16 | 39.37 | 25.71 | 27.83 | 20.24 | 15.59 | 10.27 | 11.69 | 9.22 | 4.66 | 22% |
| 23% | 26% | 26% | 31% | 17% | 25% | 34% | 35% | — | — | — | — | — |

earn higher long-term returns. For our investment portfolio to grow at a faster rate, we will need to find profitable opportunities to increase premium volume.

## REVIEW OF 2007

Rather than review the year in a Management's Discussion and Analysis format, which you can read starting on page 79 of the report, we thought we would share some of the 2007 highlights from our perspective.

**Operations**

On the operations side, we made significant progress in a number of areas in 2007. Probably the most exciting news is that Markel International reported underwriting profits for the year. MINT ended the year with a 93% combined ratio and earned $46 million in underwriting profits. In addition, the quality of the balance sheet and loss reserves are as strong internationally as they are in the U.S. Our London Insurance Market business has come a long way since the Terra Nova acquisition in 2000. While it has taken longer than we would have hoped, the business is worth much more today than we paid for it, and it is now earning solid returns on our capital. To put icing on the cake, MINT paid its first cash dividend to Markel Corporation in 2007.

In the U.S., our operations produced excellent underwriting results. Markel Shand again led the way, producing $136 million of underwriting profits on its professional liability book of business. It was another great year at Markel Essex as it produced $78 million of underwriting profits. Markel Southwest Underwriters and Markel American also made significant contributions with combined ratios in the low 80's. Markel Insurance Company continued its string of strong performances, producing a combined ratio in the low 90's. Markel Underwriting Managers' results continued to improve in 2007, and we are delighted with the turnaround that has occurred there over the past few years. While still reporting underwriting losses in its start-up phase, Markel Global Marine and Energy added product capabilities during 2007 and is on track to produce underwriting profits in 2008.

However, there were some disappointments in 2007. Virtually all of our businesses gave up ground in terms of premium writings. Premium volume was down 7% as the insurance market continued to soften. In addition, while still strong, underwriting margins slipped. Our businesses produced good margins in 2007, but not at the levels of the past few years, and the market is becoming even more challenging.

At Markel Re, we failed to meet our goals and expectations. While three of the four major product areas are profitable and have bright futures, our business model in the Specialized Markel Alternative Risk Transfer (SMART) product line simply did not work. Several factors contributed to our underwriting losses and they varied by program. However, the most common problem across all the programs written by SMART was our delegation of underwriting authority to managing agents without, in hindsight, sufficient underwriting oversight. We have long known the risks of delegating underwriting authority and have re-learned an expensive lesson.

During the first quarter of 2008, we will be transferring the three profitable Markel Re products to Markel Underwriting Managers and a scaled down, better controlled and refocused alternative risk transfer capability to Markel Insurance Company. These transfers will allow us to better manage the expenses of these programs and provide the necessary resources to seek profitable growth.

**Investments**

On the investment side of our business, performance was solid in 2007 despite one of the most challenging investment markets in recent memory. The investment environment in 2007 was chaotic, and we steered clear of most of the problems. Our investment portfolio continues to be managed with the same long-term, disciplined focus on earning superior total returns over time.

Our total investment returns in 2007 were 4.8%, with fixed income producing a return of 5.6% and equities producing a small loss of 0.4%. We are particularly pleased with the fixed income results as they show the value of sticking to our plain vanilla approach of investing policyholder funds in high quality securities with minimal credit risks. We avoided the debacle faced by many larger and more sophisticated investors in the fixed income markets by our stubborn insistence on basic and uncomplicated credit quality. As Will Rogers once said, "I'm more concerned about the return of my money than the return on my money." When it comes to fixed income investing, we are disciples of Mr. Rogers.

On the equity side, we remain committed to our four-part philosophy by which we select our investments. We look for profitable companies with good returns on capital, run by honest and talented management, with reinvestment opportunities and capital discipline, at fair prices. While our 2007 loss of 0.4% was disappointing, our five-year and ten-year returns were 11.8% and 10.7%, respectively, and we think these are a better representation of the economic returns achievable from our equity investing activities.

During 2007, our equity performance suffered on a relative basis due to our large holdings in several financial and consumer-related businesses and minimal holdings of energy and commodity firms. As the famous investor John Templeton once said, "The five most expensive words in investing are, this time it is different." In the equity markets, participants are acting as if things are different this time in that they seem to believe that energy and commodity prices will remain high and that the consumer and financial sector will remain depressed indefinitely. We do not believe that this will prove to be the case.

Technological progress throughout time has done nothing but make basic materials and energy less expensive and more efficient. We believe this process will continue, and intellectual and financial capital will continue to outperform physically-based substances such as energy and commodities. As a result, our portfolio contains a preponderance of companies with intangible intellectual capital, brand values and financial service and intermediation skills. We think these sorts of companies ultimately provide even greater protection against inflation than physical commodity-based companies due to their abilities to re-price their goods and services regularly and to not be forced to spend ever higher amounts to replace depleting physical assets.

Additionally, we retain our long-term confidence in the world's financial system which is predicated on the vast majority of debtors paying their debts. Without that behavior the system collapses. The financial system is the central nervous system of our modern world. Without functioning banks, securities markets and insurance, modern life as we know it would cease. Consequently, we expect that normalcy will return as the current episode of irresponsible lending practices and unwise securities market behaviors gets digested by the overall system. Lenders are already more prudent and securities buyers are more chastened than during the boom times. The sober practices of today will restore profitability and normality to the system. We simply have no choice. The banking and savings and loan crisis of the early 1990's and its historical ancestors from 1974, 1929, 1907 and the 1870's give the government, individuals, corporations and the markets, plenty of time-tested approaches to heal the system.

This time it is not different. Fixing these problems is not discretionary now as it was not then. All of us will do whatever it takes. Noted economist Herbert Stein observed that, "If something cannot go on forever, it will stop." A corollary of this law is that, "things that must happen, will." This is one of those things that simply must happen.

This time is also not different in that the naysayers about America are wrong, just as they always have been in the past. For 300 years, the American economy has made forward progress and will continue to do so. With the low exchange value of the dollar, the export sector of our economy is already showing signs of strength. Additionally, anecdotal evidence of foreign buyers purchasing real estate assets shows that real estate prices will stop somewhere short of zero. New York City real estate remains particularly strong. This is probably directly attributable to foreign purchasers and their familiarity and confidence in the long-term future of New York. We have also heard stories of depressed Miami condominiums as well as apartment projects in Richmond, Virginia being purchased by foreign buyers.

Our point is that skepticism about the future of America is misplaced. The notion that you must invest internationally as the only avenue for substantial growth is wrong when considered as an either/or proposition. Enterprising and well run companies will prosper in the U.S. and internationally. Opportunity abounds in emerging markets as well as those that are more well-established. Our portfolio is stuffed with companies that benefit from economic activity wherever it occurs.

Fundamentally, we believe that this time is not different. Our time-tested approach will once again produce solid investment returns. The current environment is one of rich opportunity. The current financial crunch will heal and pass as all others have done before. The world is growing and quality businesses that benefit from this worldwide growth are on sale. Dividend yields from a well-diversified equity portfolio match or exceed current bond yields, a condition that hasn't existed since the 1950's. These are the types of companies that we own. We are optimistic about their future and our ability to share in their success as owners.

## ASSOCIATE ENGAGEMENT SURVEY

Another highlight of 2007 was the completion of the first Markel associate engagement survey, where we asked all Markel associates for their opinions on a number of issues. One of our most important tasks is building and maintaining the Markel Style, and we wanted to know how we were doing. What better way than to ask those who live the Style every day?

We were delighted that over 93% of our associates took time to fill out the survey. According to the firm that administered the survey, this was a stunning response rate, confirming that our associates are engaged and care about their Company. The results were very encouraging, and it is clear that at Markel we live, breathe and love the Markel Style. The Company scored very high, at least 90% favorable responses, regarding its social responsibility, customer focus, quality of products and ethical business dealings. It was also gratifying to see that 93% of our associates felt that they had a good understanding of the Markel Style and that 95% responded that they were committed to the success of our organization.

We also learned that Markel associates are very proud of their Company and both agree with and share its goals. Another positive finding was that a similar number of associates believe that the Company has the correct plan and will be successful in the future.

However, the survey was not all good news. We found that we could do a better job providing Markel associates with career development, training and advancement opportunities. Our associates also believe there are opportunities for more and better collaboration between our business units. We are committed to addressing the areas identified for improvement and have established goals and action plans for 2008. We will repeat the survey after the action plans have been completed and will report our progress.

## CORPORATE GOVERNANCE AND MANAGEMENT ACCOUNTABILITY

Corporate governance continues to receive increased public interest and attention. In this year's annual report, we want to discuss our thoughts about good governance.

The Markel Style is the best starting point in looking at this issue. The Style is Markel's value statement and defines our core principles. We are committed to success. We believe in honesty and fairness in everything we do. We understand our responsibility to every constituency: customers, suppliers, associates, the community and shareholders. We operate and seek solutions where everyone can win and enjoy success. These principles are communicated to all Markel associates and we make them part of the way we operate on a daily basis. Fundamentally, good corporate governance is about these same principles; it's all about finding the best alignment of the interest among all stakeholders.

In our early days of planning to become a public company, we clearly defined the responsibility of executive management to the Company and its shareholders, as well as the important primary rights of shareholders. We are happy to be accused of copying Berkshire Hathaway from time to time and have admittedly done so in our borrowings from Berkshire's

"Owners-Related Business Principles." It is no accident that we have always headed this letter "To our business partners" because we truly think of our shareholders as our business partners. In addition, you are our family, friends, neighbors and business associates. It just makes sense to treat you honestly and fairly.

As the years have progressed, the rules and regulations concerning corporate governance have continued to grow and become more and more complicated. Committee charters, independence rules, financial expertise requirements, attendance disclosures and many other issues are meticulously defined and regulated. While much of this is valuable and prevents abuse, it also creates bureaucracy. It exposes everyone to the risk of paying too much attention to form and not enough to substance. At Markel, we continue to recognize the importance of complying not only with the rules and regulations, but more importantly with the underlying principles of good governance.

**Management Compensation**

At the heart of corporate governance is the alignment of interest between executive management and the shareholders, particularly as it relates to compensation and objective performance evaluation.

Markel's compensation policies have been very consistent for many years. We want all Markel associates to receive a competitive base salary and a solid package of benefits to provide for families, health and retirement. More importantly, we want associates to have the opportunity to earn meaningful bonuses as a result of achieving challenging goals and the opportunity to build personal wealth through participation in the Markel stock ownership plans.

Every company has finite resources. To the extent they are spent for the executives, they are not available for the Company or its shareholders. We have always believed that the Company and its shareholders have first call on these resources. Executives should participate through bonuses only after the achievement of superior returns. In addition, they should participate by being shareholders as well.

In recent years, executive compensation in many companies has increased much faster than seems rational. We do not believe this has happened at Markel. While we want and expect to be paid reasonably and fairly, our board has used common sense and good judgment to establish executive management's compensation levels. We do not use compensation consultants and we do not keep track of every competitor's program. We simply want to be absolutely certain that Markel shareholders get a fair deal as regards executive compensation.

For example in 2005, primarily due to the hurricane losses from Wilma, Rita and Katrina, our results were short of our objectives and your executive management team's bonuses suffered (as they should have).

The executive team has a very simple bonus plan based on five-year compound average growth in book value per share. This has been our primary financial benchmark for judging our performance for many years. It also makes a lot of sense as growth in book value per share incorporates both underwriting and investing and a rolling five-year period focuses our attention on the long term. We believe this approach follows our goal to build financial value over the long term.

Stock ownership is also a very important component of our compensation philosophy. Many companies believe stock options achieve this ownership mentality. We disagree. We do not use options as part of our ownership programs. We believe purchasing, paying for and assuming the downside risk are all integral components of stock ownership. All senior managers at Markel are expected to invest in the Company and own a multiple of their salary in Markel stock. We have established many opportunities for this to occur. All U.S. Markel associates who participate in our retirement plan receive part of Markel's contribution in Markel stock. We have payroll deduction plans as well as low interest loans to help encourage stock purchases. And finally, a substantial portion of many of the senior executives' annual bonuses is paid in restricted stock. An important element of these plans is the education of associates so they understand the economics of the Company and stock ownership. At year end, associates owned more than 10% of our outstanding shares with a market value of just under $500 million. This is over 3 times as large as our annual base compensation expense. Markel associates are economically focused on building the value of the Company.

### Objective Evaluation of Performance

It is impossible for any self-evaluation to be totally objective. While corporate financial statements are independently audited, they are management's financial statements. Accounting rules have become diabolically complicated and difficult to understand. In spite of this environment, we have tried to remember the good old fashioned principles of accounting. We work to have consistent and conservative accounting policies and apply full disclosure to all important information necessary for our shareholders to form independent judgments about the Company's performance and future prospects. We communicate both good and bad news. We try to avoid too much sizzle and just give you the facts.

At any given point in time, our financial statements include many estimates, particularly as they relate to our loss reserves. Over the years, we have provided a great deal of information about how the reserving process works at Markel. In this area, we consistently seek to establish reserves that are more likely redundant than deficient, that is we would rather reserve too much than too little. While somewhat complicated, the schedule on page 103 of Management's Discussion & Analysis discloses our actual results as compared to our initial loss reserve estimates. We encourage you to read these disclosures and draw your own conclusions.

We consistently try to fully explain our philosophy and thought process around important business issues as well as our results. It helps that our financial goals can be stated in one simple sentence: "We seek to earn consistent underwriting profits and superior investment returns to build shareholder value."

## STOCK PRICE AND STOCK VALUE

We generally do not discuss the market price of our stock. However, we share another Berkshire Hathaway shareholder principle that is closely related to treating you as business partners. It involves how we think about our stock price, our business and our long-term orientation. Our goal is to build the financial value of the Company over the long term, and we would like the stock price to reflect the Company's underlying value as consistently as possible. We, and we hope you, understand that during short periods of time, the stock price may not move exactly or even in the same direction as the Company's intrinsic value. For the Company and its long-term owners, it is not in our best interest for the price of our stock to be either unrealistically too high or too low. Consequently, we try to communicate as openly and consistently as possible to help the marketplace make reasonable judgments about our intrinsic value. Over long periods of time, we think that this has indeed occurred.

Part of our effort to have the closest correlation between stock price and intrinsic value involves attracting shareholders who have a good understanding of our business and share our long term orientation. Ideally, they will also think of themselves as our business partners and will look at our long-term results and future prospects more than the daily fluctuation of the stock price. We believe that one of our great strengths is that we have just such a shareholder base.

In order to continue to enjoy this wonderful state of affairs, we have consistently communicated and will continue to consistently communicate our current and future prospects to enable you to make rational judgments about the business, evaluate our results and form reasonable expectations.

Over the past 20 years, we have increased virtually all indicators of value by over 20%. The stock price has followed suit. Of all the indicators of value, we think book value per share and our ability to grow it are the best. That's why growth in book value is the measure for our executive bonus plan. During 2007, we increased book value by 15%; however, during the same period, our stock price was basically flat. Over the past five years, book value has compounded at 18% and our stock price appreciated at a fairly similar annual rate of 19%. While we would like for the two to move exactly in parallel, we do not have control over the multitude of factors that influence the financial markets on a daily basis. Instead, we focus on what we can control, growing book value, and understand that over time the stock price will follow.

## PLANNING FOR THE FUTURE

Reading this letter, you may have noticed two small name changes that have large implications. For over 75 years, the Markel name has been held in high regard throughout the insurance industry. We realized that we need to do a better job of capitalizing on the integrity and financial strength of Markel Corporation while continuing to give our customers the individual care and attention that they have come to expect and deserve from each of our units. As a result, Shand Morahan and Essex changed their names to Markel Shand and Markel Essex. These were the last units within the Company that did not use Markel in their names. The name changes will allow us to better capitalize on the strength of the Markel brand.

Over our history, Markel has grown and developed our business in a decentralized manner, establishing new business units every few years. As each has grown, we have increasing areas of overlapping businesses as well as duplication of back office functions. One of our most interesting 2008 initiatives is one we have named Atlas. At Markel, it's not a project until you give it a name, preferably developed in a contest. As you know, an atlas is a collection of maps. Our goal with Atlas is to create a map for Markel's future operations. We are closely examining what we're doing and how we're doing it and asking ourselves if there is a better way for the future. Fortunately, nothing operationally is broken. However, technology and the marketplace are constantly changing and we want to make sure we understand those changes and constantly adapt and improve. The bad news is that we'll be spending money and time on this project. The good news is that we believe it will help us develop the best strategy for Markel's future.

## CLOSING COMMENTS

Our crystal ball has never been very good. Nevertheless, we expect, with some degree of confidence, the insurance and investment markets to be challenging in 2008. At Markel, we believe we have some of the very best insurance and investment professionals anywhere. In spite of difficult markets, we will find opportunities to profitably underwrite and invest to continue to build the strength and value of your Company.

We thank our associates, shareholders and customers for being part of our success.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*President and Chief Operating Officer*

Steven A. Markel
*Vice Chairman*

Paul W. Springman
*Executive Vice President*

Thomas S. Gayner
*Executive Vice President and Chief Investment Officer*

Richard R. Whitt, III
*Senior Vice President and Chief Financial Officer*

*From left to right: Paul W. Springman, Anthony F. Markel, Thomas S. Gayner, Steven A. Markel, Alan I. Kirshner, and Richard R. Whitt, III.*

2008

## TO OUR BUSINESS PARTNERS

In this year's annual report, we hope to fully communicate our 2008 results and some of our plans for 2009 and beyond. We take seriously the trust that you have placed in us, and we view this report as an integral component of the accountability we owe you. Our job is to protect and build Markel's capital over time. Unfortunately, the collapse of the financial markets in 2008 went beyond what we predicted or expected, and we did not accomplish our goal this year. In 2008, our book value per share declined 16% to $222.20 per share. Over the past five years, book value per share increased at a 10% compound annual rate.

If we had predicted in last year's letter that the following would occur during 2008, would you have believed us?

- Insurance prices would continue to decrease and a major hurricane would hit the Houston metropolitan area. Despite this, Markel would report a 99% combined ratio for the year.
- Worldwide financial markets would implode, experiencing their worst declines since the Great Depression. Markel's equity portfolio return would be a loss of 34% with over $400 million of realized investment losses. Despite this, Markel would outperform the S&P 500 index.
- Even with the insurance and financial market problems, Markel would end the year with low financial leverage and senior debt rating upgrades from two rating agencies. We would hold $1.1 billion of cash and short-term investments on a consolidated basis and $651 million of cash and investments at our holding company.
- Markel would end the year in a much stronger financial position than AIG, Citigroup and Bank of America. We did so despite the fact that these firms received hundreds of billions in federal bailouts.

How can we describe the 2008 year and what occurred in the financial markets and at Markel? More important to you, our shareholders, how do we assess our performance during 2008? Words a shareholder

| *(in millions, except per share data)* | **2008** | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|---|---|---|---|
| Gross written premiums | **$ 2,213** | 2,359 | 2,536 | 2,401 | 2,518 | 2,572 | 2,218 | 1,774 | 1,132 |
| Combined ratio | **99%** | 88% | 87% | 101% | 96% | 99% | 103% | 124% | 114% |
| Investment portfolio | **$ 6,908** | 7,788 | 7,535 | 6,588 | 6,317 | 5,350 | 4,314 | 3,591 | 3,136 |
| Portfolio per share | **$703.94** | 782.18 | 753.98 | 672.34 | 641.49 | 543.31 | 438.79 | 365.70 | 427.79 |
| Shareholders' equity | **$ 2,181** | 2,641 | 2,296 | 1,705 | 1,657 | 1,382 | 1,159 | 1,085 | 752 |
| Book value per share | **$222.20** | 265.26 | 229.78 | 174.04 | 168.22 | 140.38 | 117.89 | 110.50 | 102.63 |
| 5-Year CAGR in book value per share[1] | **10%** | 18% | 16% | 11% | 20% | 13% | 13% | 18% | 21% |

[1] CAGR—compound annual growth rate

might use include "disappointing" and "poor." If you wanted to be more critical, you could use words like "disastrous" or "worst year ever." While all these words could be used to sum up Markel's 2008 results, we believe another word should also be added in the mix, "opportunity."

To be fair, it was not a good year, and you have every right to be disappointed, but we ended 2008 prepared unlike any other time in our history to take advantage of enormous opportunities in the years ahead of us. We enter 2009 with the capital, both financial and human, to take advantage of the growing opportunities in the specialty insurance marketplace, as well as investment opportunities that will eventually emerge as financial markets heal.

## TWENTY-YEAR PERSPECTIVE

Here is an updated 20-year chart from last year's letter. A year ago we remarked, "We present the 20-year table to remind you, and us, of the importance of maintaining a long-term perspective." Last year was a good year. This year was not. Throughout the decades, our underlying philosophy and long-term vision remain the same. We think it is just as important to remember this in a year when things did not go as well as we would have liked.

This year's numbers do not make for the best reading. We achieved total gross written premiums of $2.2 billion in 2008, a decline of 6% and a level similar to the amount of business we did in 2002. The insurance market has endured declining prices for the past several years and 2008 showed no relief. While we believe our underwriters maintained their discipline and let business leave us for cheaper rates, our overall pricing and margins diminished along with the industry. The vast majority of our business continues to earn underwriting profits; however, the margins are now too thin. The time has come to move prices up, and we have started this process.

The flat volume over the last five years contains both good and bad news. The good news is that we worked diligently to maintain our underwriting discipline despite increasingly irrational competition. We also were able to grow book value through this period even with flat top-line revenues. The bad news is that we have not had enough success finding the opportunities for profitable growth that do exist. This is not for lack of effort. Our experience tells us that we must try many new product ideas to find the few that can make a significant contribution. While we enjoyed some modest successes over the past few years with our new initiatives, none have been large enough to offset the volume we continue to lose due to market competition.

Underwriting results for 2008 reflected the competitive insurance market, as well as Hurricanes Gustav and Ike. Despite these obstacles, we finished the year with a combined ratio of 99%. Of course our

| 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 | 1990 | 1989 | 1988 | 20-Year CAGR[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 595 | 437 | 423 | 414 | 402 | 349 | 313 | 304 | 406 | 412 | 44 | 43 | 22% |
| 101% | 98% | 99% | 100% | 99% | 97% | 97% | 97% | 106% | 81% | 78% | 84% | — |
| 1,625 | 1,483 | 1,410 | 1,142 | 927 | 622 | 609 | 457 | 436 | 411 | 79 | 59 | 27% |
| 290.69 | 268.49 | 257.51 | 209.20 | 170.95 | 115.45 | 112.55 | 84.64 | 81.77 | 77.27 | 14.54 | 11.35 | 23% |
| 383 | 425 | 357 | 268 | 213 | 139 | 151 | 109 | 83 | 55 | 60 | 45 | 21% |
| 68.59 | 77.02 | 65.18 | 49.16 | 39.37 | 25.71 | 27.83 | 20.24 | 15.59 | 10.27 | 11.69 | 9.22 | 17% |
| 22% | 23% | 26% | 26% | 31% | 17% | 25% | 34% | 35% | — | — | — | — |

goal is to earn consistent underwriting profits. We have done a good job in recent years, producing underwriting profits in five of the past six years. We barely missed in 2005 with a 101% combined ratio as a result of Hurricane Katrina. Over the past 20 years, we have produced underwriting profits in 14 out of 20 years. Our misses were primarily related to the acquisitions of Shand, Investors and Terra Nova and Hurricane Katrina. Given the current low investment returns, we need to earn combined ratios in the low 90's or better to achieve reasonable returns on capital.

Over the past five years, the compound annual growth rate of Markel's book value per share stands at 10%. By comparison, the five-year compound annual growth rate of the S&P 500 was a loss of 1.5%. Despite our relative outperformance in book value growth and the 3.4% compound annual growth in Markel's share price over this period, these results are below our goals and expectations. Consequently, as you would and should expect, your executive management team earned no bonuses this year. We have all witnessed recent examples of executive compensation excesses. At Markel, we have always tried to treat shareholders and our associates fairly.

As evidence of the long-term effectiveness of our approach, we can look to our success in growing book value with a 20-year compound annual growth rate of 17%. Our objective for 2009 is to return to historical form and build book value per share at high rates of return over long periods of time.

Inside the front cover of this year's report are our Profile and The Markel Style. Like our 20-year record, this mission statement and our value system remained consistent throughout the period. We continue to believe that these principles reflect unchanging truths, and they will lead us to success in the years to come just as they have in the past.

## REVIEW OF 2008

The best thing we can say about 2008 is that it is over. It is also a year when we learned a great deal about volatility, resilience, flexibility and margin of safety. We look forward to applying those lessons in 2009 and beyond.

**Operations**

Given the difficult underwriting environment we faced in 2008, producing a 99% combined ratio for the year represents a modest success. Our results included $95 million of losses, or almost five points on our combined ratio, from Hurricanes Ike and Gustav. We are pleased that this represents a $20 million improvement from the loss we initially estimated on the hurricanes in our third quarter results.

Hurricane Ike was a bigger (over 500 miles wide) and more extended storm than any previous hurricane. Based on analysis of our losses from Ike and Gustav, we believe that the underwriting corrective actions that we put in place after Hurricane Katrina are working. There is still work to do, but we are pleased to have met our goal of producing an underwriting profit in a year with significant hurricane losses.

In addition to hurricanes, we continued to combat rate pressure throughout most of 2008. Fortunately, as we approached the end of the year, rates began to stabilize in many classes. However, given how far rates have fallen over the past several years, stable rates are not enough. During the fourth quarter, we instructed all of our underwriters to stop offering rate decreases, and we followed soon after with targeted rate increases for most of our lines of business. In the short run, being among the first to stand up to the need for rate increases may hurt our premium volume. This, however, is a small price to pay. Inadequate pricing will get an insurance company in trouble much faster than losing premium volume (more on this subject later).

In the United States, our operations produced good results, although they were tempered by storm losses and price deterioration. Markel Shand and Markel Essex again led the way with solid, but smaller than 2007, underwriting profits. Markel Southwest, Markel Insurance Company and Markel American also made solid contributions; however, all were impacted by the storms and soft market. Markel Underwriting Managers and Markel International reported underwriting losses for the year. At Markel Underwriting Managers, this was largely due to extreme price competition in their lines of business and the need to establish significant margins of safety as a result. At Markel International, storm losses and problems in a medical malpractice book led to an underwriting loss.

To produce a consolidated underwriting profit, we also had to overcome a few disappointments in 2008. Our team at Markel Global Marine and Energy worked extremely hard to build a franchise for us in Houston; however, we were not able to generate the critical mass necessary to sustain the operation. We made the difficult decision to close this unit at the end of the year. We also made the decision to exit medical malpractice at Markel International. This was an experiment to reproduce our profitable U.S. medical malpractice results in Europe. While we were unable to make these expansion efforts work, we will continue to look for profitable growth opportunities.

**One Markel**

You may remember from last year's letter that we talked about our Atlas project and how we were building a roadmap for our future through it. During 2008, we continued to refine the vision for the project and renamed it One Markel. The reason for the name change was simple. While we have many goals for One Markel, the primary goal is to get closer to our customer with the full array of Markel's product offerings. We want to be easier to do business with, find out about new business opportunities more quickly and become more efficient in providing insurance solutions to our customers. We want to give each of our customers one access point to Markel through regional teams dedicated to bringing them the right Markel products and services.

By spring 2009, we will transition our four wholesale business units to a regional structure. We have split the country into five regions: Northeast, Southeast, Midwest, Mid South and West. Each regional office will be responsible for serving all the needs of the customers located in their regions. Each regional team will have the full menu of Markel products available to serve their customers.

With our regional teams focused primarily on customer service and marketing, we have created a central product line group that has primary responsibility for underwriting guidelines, pricing and program design. The product line group's focus will be to ensure that the products needed by the regional teams' customers are available and that our regional teams have the expertise to underwrite the risk or can refer more difficult risks to our product line experts.

We have been preparing for this transition throughout 2008. We opened the Mid South regional office in Dallas, Texas in September 2008. Opening this region early gave us the opportunity to refine our plan and train our associates before rolling out One Markel to the other four regions of the country. Initial reactions from our customers in the Mid South region are very encouraging. We want to thank them for their support and patience as we worked through the details.

During 2008, almost every Markel associate was involved in moving the One Markel vision forward. Many of our underwriting and support area associates, over 40 at last count, relocated to staff the regional offices with the right skill sets. Many associates accepted new responsibilities in the new shared services areas and many have been working to develop the new systems and processes that will support One Markel. During that time, many of them have been doing their old job, as well as their new job. We want to thank these associates for doing what it takes to make this a success for our customers and Markel.

As we worked throughout the year on the One Markel initiative, we realized that the new model would require us to lead and manage the company slightly differently. As a result, we asked several of our senior managers to take on new roles and responsibilities in the organization.

Earlier in 2008, Tony Markel announced that he wished to move out of his daily responsibilities as President, and he became Vice Chairman. He will continue to provide strategic guidance as well as serve as a member of our Board of Directors. At the same time, we promoted Paul Springman to President and Chief Operating Officer. Paul joined Markel in 1984 as an underwriter and his roles and responsibilities grew over the years. During 2009, Paul will focus primarily on the transition of Markel's wholesale units to the One Markel regional model. The five regional presidents will report directly to Paul. While he will continue to be involved in all major decisions affecting the operations, our intent is to allow him to be able to devote the majority of his time and attention to the success of One Markel.

We promoted Gerry Albanese to Chief Underwriting Officer. He will oversee all of Markel's underwriting through the newly formed product line group. Gerry is fresh off a five-year assignment as President of Markel International. Gerry joined Markel 24 years ago and he is one of our most talented underwriters and administrators. We are delighted that Gerry has taken this crucial role, and we believe that he will ensure that our underwriting standards are enhanced in the new model.

With Gerry's return to the United States, we are also pleased to report that William Stovin has been named President of Markel International. William will partner with Jeremy Brazil to further develop our international platform. William and Jeremy have been with us for twelve and eleven years, respectively. They helped us successfully navigate the transition of Terra Nova to Markel International and are ready for this new challenge.

Britt Glisson has been named Chief Administrative Officer and will have responsibility for the new shared services units being created to support our regional underwriting offices. Britt joined Markel in 1990, and since 1996, he has been the President of Markel Insurance Company. During his Markel career, Britt played an integral role in a number of initiatives that helped Markel grow its business and operate more efficiently. He also has leadership experience both on the wholesale and retail side of our company.

We are also pleased to welcome Mike Crowley as President of our Specialty Program Division. In this role, Mike will oversee our specialty business, including Markel Insurance Company and Markel American Insurance Company. Mike has more than 30 years of extensive retail experience, and he is looking forward to joining the company side of the business. With his experience, Mike can bring an innovative perspective to Markel. He worked for HRH since 2004 and held a variety of leadership positions including President and Chief Operating Officer.

As you can see, we benefit from an extremely experienced and talented team ready to pursue the many opportunities we see in 2009 and beyond.

**Insurance Industry Pricing**

For the industry as a whole, it is clear that both capital and underwriting margins are depressed. With diminished industry underwriting profits (the industry shifted to a loss in 2008), capital and balance sheet pressures from sour investment markets and increasing pressure from regulators and rating agencies seeking greater measures of solvency and financial soundness, insurance prices must increase. While there has been a delay of game as governmental actions propped up major industry competitors, this cannot go on forever. Sooner or later, the unprofitable companies in the insurance industry will run out of money to run out of. We've seen this cycle before and it will play out the same way it always does—pricing will go up.

As 2008 ended, many in the industry started talking about the need to achieve higher prices. Unfortunately, for many it was only talk. At Markel we are aggressively seeking much needed price increases. We believe these increases are needed and justified for the following reasons:

First, and maybe most obviously, prices have been coming down for several years. Prices have now reached a level where there is no room to move any lower—they must go up.

Second, the economy is in a downturn, and we have officially entered into a recession. Insurance claims always increase in difficult economic times, and we must anticipate that this trend will repeat. We must increase insurance rates as we expect claims to increase.

Third, the current economic environment has also resulted in the lowest interest rate levels seen in many, many years. We incorporate interest rates in our return on capital financial models. With lower investment returns on our "insurance float," we must have higher prices to achieve reasonable return objectives.

Finally, and most importantly, we must increase prices to assure that we earn underwriting profits. Underwriting profits are necessary for Markel to provide our customers with the financial security they expect when they buy our insurance policies. Underwriting profits are necessary for our associates to enjoy long-term career opportunities and so that we can be a productive corporate citizen in our communities. Underwriting profits are also critical to meeting our promise to our shareholders that we will build the value of their Company.

**Investments**

Today's financial markets defy description. The escalating series of bankruptcies, actual and de facto, throughout the year were unimaginable to us a year ago. Despite our lack of imagination, they happened. At the moment, recovery and prosperity seem unimaginable and distant at best. We remain optimistic though, and we suspect that we will be pleasantly surprised by the resiliency and forward progress the worldwide economy will demonstrate as we move through 2009 and beyond. We look forward to a season of pleasant surprises. It will happen, even if the timing is uncertain.

Current events remind us of the cyclicality of economic patterns and the powerlessness of authorities to prevent them. Only a few years ago, Enron and WorldCom served as poster children of cowboy capitalism and flawed regulation. Few would expect that after regulatory responses such as the Sarbanes-Oxley measures, along with fresh scars of chastened investors, that 2008 would see Fannie Mae, Freddie Mac, Bear Stearns, Wachovia, Lehman, AIG, Washington Mutual and Merrill Lynch among others, ALL failing or requiring massive government support to keep the doors open! Additionally, previous blue chip stalwarts such as Citigroup, Goldman Sachs, Morgan

Stanley and Bank of America comprise just a small portion of the list of financial institutions that required major government assistance to survive.

While we were nervous and cautious a year ago, in hindsight, we were not nervous enough. We did not anticipate the magnitude of the 2008 financial crash. We have and continue to maintain a high quality, plain vanilla fixed income portfolio. As such, we missed most of the first wave of problems as the credit markets began to deteriorate in 2007. We didn't own sub-prime mortgages or complicated structured finance instruments. We attempted, as always, to maintain a very high quality bond and equity portfolio. Despite our efforts at diligence, we did own some senior debt securities of companies from the previous list. Many of these firms did engage in what we now know were unsound and too highly-leveraged business activities. Consequently, we experienced permanent losses of capital from our debt holdings in Lehman, Washington Mutual and Fannie and Freddie. These losses made our fixed income returns lower than they should have been. Going forward, we will be more opportunistic regarding corporate bond exposures. In the past, we maintained a normal corporate bond exposure of roughly 33% of our total fixed income holdings. In the future, if corporate bond prices are attractive, we will invest in the sector. If corporate bond prices do not carry sufficient risk premiums, we will reduce our exposure to the sector significantly.

We also suffered permanent losses in our capital from the equity positions we sold in Citigroup, MBIA, LandAmerica and miscellaneous smaller holdings. Market values of just about everything except cash and treasury securities declined. We expect our mark-to-market losses to be temporary and not permanent in nature. In total, during 2008, our fixed income investments had a total return of 0.2% and our equity securities a total return of (34%). Our entire investment portfolio posted a decline of 9.6% including the negative effects of 2.7% from foreign currency translations. In keeping with the "worst ever" records set throughout the financial world in 2008, this is the worst total return performance in the history of Markel. It is the first negative return for the portfolio since 1999, a year in which the portfolio declined 1.3%. While these results are better than many, they are disappointing to us.

The crisis in the financial markets and its impact on the economy will take time to heal. 2008 marks a major turning point in global economics. For decades, consumer consumption and financial leverage increased systemically. This occurred in both the U.S. and many economies around the world. Everybody seemingly benefitted as economic activity increased. Consumers didn't really care if the money for the bigger house and the new car came from debt or equity. The house was still bigger and the car still smelled new no matter where the money came from. The businesses and people who built those houses and cars also enjoyed the good times of growing commercial and consumer activity. In addition to those tangible products such as houses and cars, the entire world of intangible activity grew as well. Financiers, advertisers, entertainers and other derivative jobs and occupations enjoyed the upswing of an apparent virtuous cycle of increasing prosperity.

This seemingly virtuous cycle of the last 20 years was financed by ever increasing amounts of debt at lower and lower interest rates. In hindsight, it created what now looks like the "mother of all bubbles." The steady increase in financial leverage now has come to an end. This will produce a period of restrained economic activity as the overall system adjusts to lower levels of debt and consumer consumption.

Along with excessive leverage, the underlying trust and confidence that modern economies need to function have been broken. Increasingly sloppy and ultimately corrupt behaviors that accompany eras of good times are now showing up in scandals such as those alleged to have been perpetrated by Bernard Madoff and others both personally and corporately. It is worth remembering as we compare our current investment environment to the dismal 1930's that we review the decade that preceded it. The 1920's were an era of excess and gaudiness that produced eerily similar consequences to those of today. Students of financial history can see parallels when studying the accounting sleight of hand behind stock options in the 1920's, financiers such as Samuel Insull and disruptive technological changes such as electrification.

While we do not expect instant healing, we fully expect that our system will recalibrate and return to forward progress. Over the next several years, it is a profoundly good bet that the world's economy will both survive and prosper. We are systemically going about the business of lowering debt levels throughout the economy and soberly resetting the moral compass of accepted business practices. We will also benefit from scientific and technological progress that will change the world for the better in ways that we can't yet even imagine.

Economic tides, like natural ones, do not stand still. While we do not expect a quick return to the boom conditions of the last two decades, neither do we expect current negative trends to persist. The conditions necessary to create the next economic expansion are underway, and we are confident that the overall economic backdrop will improve in coming years.

In 2008, our investment results were painful as we failed to avoid the price declines experienced in almost every asset class. As we mentioned earlier in this letter, while we invested defensively starting in 2007, in hindsight, we were not defensive enough.

Specifically, we spent most of the last two years pursuing the following actions. We began reducing equity exposures from a high of over 75% of shareholders equity in December of 2006 to 49% by December of 2008. The reductions came from reinvesting less than we received as we sold equity securities over the last two years and not investing as much of our cash flow as normal into equities. The dramatic price declines in the equity market also served to reduce our exposure. That is the hard way to bring the percentage down, and we hope not to do so that way again. We are realistic enough to know that the market will do that to us from time to time in the future. We need to maintain a margin of safety that can absorb the inevitable downturns in future financial markets.

On the fixed income side, we also harvested maturities and reinvested less than sales. The objective was to increase cash and liquidity, shorten the overall duration to minimize risks from future inflation, and increase credit quality. As was the case in equities, we were directionally correct in these goals, we were just too slow in turning those goals into decisions and results. As a result of these steps, cash and short-term investments grew from $529 million at the end of 2007 to $1.1 billion by the end of 2008. Unlike most years in the past as well as our expectations for the future, cash was our best performing investment.

Over the years, we've been gradual when we've made investment decisions like the ones we just discussed. In large measure, we believe in gradualism because it salutes the important measure of humility that any investor should bring to the task. The future is unknowable, and all decisions are probabilistic estimates about shades of grey. We are proud of our long-term record, but we remain humble about our abilities. We use the disciplines of time, measured steps and consistency to improve our odds of good outcomes. In retrospect, pure unadulterated panic would have been the best investment approach to take in 2008. Prospectively, while we are sure that a year will come along where panic looks good again, we don't think it is a reliable setting for the North Star on our investment compass.

## INVESTMENT ACCOUNTING COMMENTS OR "WHAT IS OTHER-THAN-TEMPORARY?"

In many respects, financial markets simply stopped functioning during 2008. In this environment, accounting rules and conventions break down and fail to function. As a result, we'd like to digress with some comments about investment accounting as practiced in 2008. Our investment accounting policy is pretty simple, or so we thought. The notes to our annual report state, "Investments are considered available-for-sale and are recorded at estimated fair value. A decline in fair value below cost that is deemed other-than-temporary is charged to earnings."

The meaning of other-than-temporary is not precise. It lies somewhere in the middle between temporary and permanent, but no one really knows, or can tell us, where. When financial markets are in chaos, quoted market prices do not necessarily represent estimated fair value. The exact same diamond can have a different value when you are purchasing it at Tiffany's to present as an engagement proposal compared to what you get for it at the pawn shop when you are trying to pay the divorce lawyer. It's the same diamond, the situation and timing are just different. What is the true value? Quoted market prices are imperfect guides to judging intrinsic value, but they normally work as a reasonable proxy and the "least worst" way to describe values. They also have the benefit of being independent and objective, and they do indicate what something might be worth at a given point in time.

An additional problem with other-than-temporary impairment involves trying to guess how long it might take for markets to return to "normal." Of course, the correct answer is no one knows when or if they ever will return to the old "normal." This makes proving that a security in a loss position is not other-than-temporarily impaired nearly impossible. Such is the current environment.

We constantly review and monitor all of our investments. We mark all of the available-for-sale investments on our balance sheet to estimated fair value using quoted market prices when available and reflect all changes in our comprehensive income. We believe our comprehensive income, the net change in book value, is the best proxy for evaluating our financial success at Markel. The longer the time frame, the truer this statement.

It is important to point out that the meaning of the words "value" and "impairment" from an accounting viewpoint does not change our view of the meaning of the same words from an investment perspective. When we think about "value" from an investment perspective, we think of intrinsic value. While we might believe that intrinsic value represents the real "truth," it is also inevitably a personal and subjective valuation that cannot be objectively documented for financial statements. When we think about an investment being "impaired," we think some of its underlying fundamentals may have changed for the worse. Usually, a market driven decline in price is a good thing that allows us to buy more of the security at a better bargain—not an impairment. While all of our securities are available-for-sale, we usually expect to hold them for the long term, usually many years. While it might be rational to connect the timing element of other-than-temporary impairment to our expected holding period, in today's environment, it is more important to take a conservative approach.

While we took charges to 2008 earnings for many investments due to our judgment that the estimated fair value might represent an other-than-temporary decline, that does not mean that we believe the companies underlying these investments are in any way "impaired" and it certainly does not mean prices will remain permanently below our cost. In fact, we expect that we will be increasing our investment in many of these companies in the future.

## CLOSING COMMENTS

While it might seem hard to believe right now given our disappointing 2008 performance and the drone of negative news headlines that seem to be waiting for us each day, we are optimistic about the prospects for Markel in 2009 and beyond. Clearly, 2009 will have its challenges, and we have worked hard to position your company to face those challenges. However, we believe that insurance market pricing will improve in 2009, and we know that the world economies will recover over time. Our new regional structure will move us closer to our customers and produce more business opportunities. Financial markets will heal, and we have the capital to invest as they recover. We have the right people on our team and will continue to profitably expand our presence in the specialty insurance marketplace. There is much reason for optimism, and we look forward to sharing much better results with you in next year's letter.

We thank our associates, shareholders and customers for their continued support.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*Vice Chairman*

Steven A. Markel
*Vice Chairman*

Paul W. Springman
*President and Chief Operating Officer*

Thomas S. Gayner
*Executive Vice President and Chief Investment Officer*

Richard R. Whitt, III
*Senior Vice President and Chief Financial Officer*

*From left to right: Paul W. Springman, Anthony F. Markel, Thomas S. Gayner, Steven A. Markel, Alan I. Kirshner, and Richard R. Whitt, III.*

**Markel (MKL) 2009 Annual Meeting**

*Disclaimer: These notes were taken in real time at the Markel Annual Meeting in Omaha, Nebraska on Sunday May 2nd, 2009 without the use of a recorder. The goal was to get the gist of the questions and as much of the answer as possible. Please excuse any mistakes or omissions.*

1. Introductory Remarks- EVP/CIO Tom Gayner:
   a. MKL has focused on liquidity over the last few years and has kept a lot of cash on hand
      i. This is what they have been doing with shareholder money recently
   b. Gayner mentioned the question that Buffett brought up at the Berkshire (BRK) annual meeting the day before
      i. What would he and Steve Markel do differently if MKL was a private company?
         1. There should never be an actual answer to this question
            a. The answer should be nothing
         2. Businesses should not be run any other way
   c. MKL likes companies that have survivability
      i. Companies that are ready, willing and able to answer the bell for the next round
      ii. Want companies that in 20 years you will still be talking about
         1. The example he brought up was Marriot (MAR)
2. Introductory Remarks: CEO Steve Markel
   a. 2008 was not an easy year to assess
      i. They need more time to properly assess the full impact and results of 2008
      ii. Looking back at it, 2008 was an historic year
      iii. They are happy with themselves on a relative basis
         1. But, they prefer to have done better
         2. In any case they are extremely optimistic about the long-term future of MKL
            a. Believe that we all need to look at MKL and all companies with a long term time horizon
            b. They understand that the current crisis will lead to many changes in the world but they feel MKL is ready to adapt as needed
      iv. Long term values are very important
         1. Companies have to build a set of lasting principles to operate under
            a. More importantly companies have to stick with these principles regardless of the operating environment
         2. Throughout the organization they have identified core principles and have stuck to them
            a. In areas in which they felt they had issues they have re-examined their processes and made the necessary changes
3. Q&A Section
   a. Questioner: David Winters (The Wintergreen Fund)
      i. Are AIG and its current practices hurting the industry as a whole?
         1. Markel
            a. Yes, a little bit. But not as badly as some people have been suggesting
            b. Clients of AIG are asking a lot of questions and there is extreme disruption in the market
            c. AIG is cutting the heart out of some of their policies, especially upon renewals so that they can keep the business

                i. About 5% of the time (Markel's estimate) AIG is doing very stupid things when it comes to renewals
                ii. The bigger problem is that the competitors are using AIG's problems and lack of pricing discipline not to raise their own prices
                    1. This is solely Markel's opinion but he believes that the insurance companies are going to have to reinvigorate and re-discipline their troops
            d. There is a lot of resistance to price increases (partially as a result of AIG)
                i. Q1 2008-Q3 2008: MKL's renewals were 5-7% below previous rates
                    1. Q4 2008: Renewals were only 1-2% below previous rates as they started pushing through price increases in Q4
                    2. Takes some time to get the price increases through
                        a. Q1 2009 should actually have a positive pricing impact based on some non-renewals and some price increases

b. Questioner: What business lines are the toughest to pass through increases?
    i. Markel
        1. Easy: Oil rigs on the Gulf Coast, hurricane property and casualty, umbrella policies, European policies
        2. Tough: Excess/surplus liability, commercial contractors, California earthquake
c. Questioner: How is the One Markel Program progressing?
    i. MKL used to be segregated by products with certain specialists located in specific offices around the country
    ii. Felt that they were missing opportunities to cross sell and were not serving clients well enough
        1. Clients did not even know about other products MKL was offering
    iii. Now have moved to 5 regional offices where they have experts in each office
        1. This has turned the organization sideways
        2. Started in 2008 in Dallas and now have rolled it out countrywide
    iv. Things are going well despite a little noise and little chaos
d. Questioner: Can you discuss the investment case for Brookfield Asset Mgmt (BAM)?
    i. Gayner
        1. MKL has a long term relationship with BAM
            a. CFO's mother used to work at MKL
        2. BAM has made some tremendous capital allocation decisions
            a. Natural resources: timber, paper mills, hydroelectric dams
            b. Have realized that the forest is a better investment than the mill
            c. Try to buy minimal capital expenditure requiring assets that will go up in value over time
                i. Thus they own better assets over time
        3. Like and trust the people who run BAM
        4. Believe it is priced attractively and expect to own it for the long run
        5. Will protect against inflation due to the hard asset focus
e. Questioner: Can you discuss the Fannie Mae (FNM) and Freddie Mac (FRE) positions?

            i. Gayner
                1. They own senior debt as well as some preferred stock
                    a. Believe that they are both permanently impaired
                    b. In the future would like to have as little FRE/FNM exposure as possible
f. Questioner: Are there conditions for economic expansion out there right now?
    i. Gayner
        1. Every business is making decisions faster and sorting things out faster
            a. Can't put off hard decisions any longer
            b. Net effect of this rationalization creates the seeds of growth
        2. Feels like the 1970's to them when there were a number of great companies created
            a. Entrepreneurialism was rampant then because it had to be
                i. This is the case now
g. Questioner: What inning are we in when it comes to this rationalization? Are the changes permanent?
    i. Gayner
        1. Quoting Jeremy Grantham he indicated that over cycles we learn nothing
            a. Only short term lessons stick in people's minds
            b. In the long term we make the same mistakes over and over
        2. Business is cyclical and circular so the changes are not likely to be permanent
        3. Felt that we still had a ways to go in this rationalization
h. Questioner: What lessons were learned in 2008?
    i. Gayner
        1. Leverage is a killer
            a. Even if you are fundamentally right you may not be able to play out your hand due to leverage
            b. This includes explicit and implicit leverage
                i. Collateral/contagion damage from the macro level can be just as devastating as on balance sheet leverage
                    1. Being levered to the system is dangerous also
        2. Don't learn the wrong lesson
            a. It's easy to make generalizations about this period that will be harmful for the future and may not even be accurate
            b. 2008 was a real rattlesnake
                i. But in the future you have to be able to discern between the real snakes and the fake snakes
                    1. You can't operate as if you are constantly afraid of finding snakes
                    2. Have to be able to dust yourself off and get back in the ring
        3. Believe their skill levels are higher after going through such a tough period
i. Questioner: In the new One Markel m odel, who has the underwriting pen?
    i. Markel
        1. Underwriting profit is the absolute most important thing for MKL as a company
        2. They are taking experts from specialist areas and are deploying them around the country in the 5 regional offices to make sure there are experienced people writing policies

            3. They are also putting in new technology systems that will help them monitor underwriting
j. Questioner: Can you discuss the future premium growth rate for MKL?
    i. Markel
        1. MKL is a much larger company than previous but the company's growth rate has been much higher than the industry as a whole
            a. In the past 20 years they have been growing faster than GDP
            b. In 2008 they had $2B in premiums written on $2B in equity
                i. In 1986 they had $50M in premiums written on $25M in equity
        2. 20% growth they have seen is not sustainable over time
            a. Now they have about $1.4B in US premiums and $600M outside the US
        3. In 2009 they expect the full P&C market to be about $450B so their $1.4B is still a very small piece of the pie
            a. Think there is a very long runway in front of them
            b. Think there is a huge opportunity to grow through organic growth and acquisitions
                i. Will be launching new products as well
    ii. Gaynor
        1. Have managed to gain scale by finding experts that could grow the MKL web in a silo-ed fashion
            a. They are now better able to leverage expert talent through technology
            b. Markel One also leads to better scale
        2. Believe that they have a lot of room to grow outside of the US as only 33% of their business is overseas
            a. World will continue to develop and grow
                i. People have tasted wealth and are not willing to give it up
            b. This is actually going to be the stronger side of the business in the future
        3. MKL is agnostic between using capital to write premiums or using it for investment purposes
            a. They are now looking to purchase wholly owned subsidiaries like BRK does
                i. They have their flag up looking for companies that would like to be under the MKL umbrella as the leveraged private equity model has not worked out so well
k. Questioner: What was their take on the BRK Annual Meeting?
    i. Gayner
        1. They didn't learn anything new per se
            a. But that is a good thing
            b. It shows that the value investing principles are timeless
        2. Don't need to learn new things when it comes to the discipline required to run businesses
            a. The BRK annual meeting is kind of like going to church
                i. You don't learn new things each week
                ii. You haven't forgotten the principles
                iii. You go to get filled up or re-filled by Buffett and Munger

l. Questioner: Is specialty insurance a sustainable business?
    i. Gayner
        1. Yes, because it solves unique problems
            a. For example data breach security
                i. This is something that 20 years ago no one was talking about
                ii. New problems emerge and new products will be necessary
    ii. Markel
        1. Insurance industry has survivability
            a. The need to transfer/share risk is always there
        2. What makes a singular company survivable?
            a. Most people would not have pegged AIG as a potential casualty
            b. 1975: most insurance companies have gone bankrupt since then
                i. High casualty rate
            c. Culture, business principles, doing the right thing will help you last
                i. MKL still young and small relatively
                    1. Want to be around at least 100 years

m. Questioner: Tom Russo (Gardner, Russo & Gardner) – Why would someone not want to buy pieces of AIG at distressed prices?
    i. Markel
        1. There is definitely interest out there
        2. AIG recently sold Hartford Steam Boiler for about $1B after recently being bought for about $2B
        3. AIG was looking for cash purchasers with the ability to write a $1B check
            a. People did not think MKL could write that check even though they were very interested
        4. Apparently the balance sheet for Hartford Steam was not as clean as people had thought and that led to the discounted price

n. Questioner: How is Terra Nova Insurance in London doing in terms of expanding throughout the rest of the world?
    i. Markel
        1. Like Buffett has done with General Re, MKL has done a post mortem on the Terra Nova deal
            a. In March 2000 they bought a damaged company for what they thought was a fair price
                i. In retrospect they paid too much because the problems were greater than they anticipated
            b. In 2000 they had about $1B in premiums and that has been reduced to $400-$500M recently
                i. Did this on purpose to rationalize the book
                ii. Getting it back up towards $600M as growth opportunities continue to present themselves
            c. Did a One Markel –like reorganization with the international division and eliminated rampant cross subsidiary competition
                i. Now have had 3-4 consecutive years of underwriting profit
                ii. Division is now providing a good float
                iii. Focusing on generating returns for shareholders has now become part of the culture internationally

                1. They came in an infused the MKL culture and it has really been beneficial
    - ii. Gayner
        - a. When people and nervous employees ask them if they have any experience with a transformation like Markel One they say yes
            - i. Look at MKL international

o. Questioner: What are the private equity options looking like right now?
- i. Gayner
    - 1. They started looking like 3-4 years ago
        - a. Thought the leveraged private equity model was flawed and would not last
            - i. Were a bit early on that call but since then it has cracked
        - b. As a result of the previous strength of the leveraged PE model they were only able to buy large, but non-controlling stakes in firms
            - i. They learned that they were not good non-controlling shareholder
                - 1. Believe that they are control freaks
            - ii. As a result they have done recent deals in which they bought 80% of the equity
                - 1. Example: AMF Equipment Machinery
                    - a. This is a company that supplies baking machines
                    - b. Will have $100M in revenues in 2009
                    - c. They are very happy with this deal
            - iii. This is a crawl, walk then run process
                - 1. Going to take it slow
                - 2. Ideal deal right now a is $5-$25M transaction
                    - a. Will grow over time
                    - b. Same deals as Buffett with fewer zeros

p. Questioner: You talked about GE as a good long last year. What happened?
- i. Gayner
    - 1. This was a hidden leverage problem
        - a. Steve Markel was suspicious of GE and Gayner wishes he had listened to Markel
    - 2. GE has been at the epicenter of the storm
        - a. They liked the idea that Welch was out and Immelt was not in the habit of smoothing out earnings
            - i. Knew that Welch manipulated earnings by looking at their insurance operations
                - 1. Thought that Immelt has done a good job de-emphasizing that
    - 3. It looked like a classic good value play
        - a. But the events of 2008 have made Immelt’s course much more difficult now
            - i. Think that the positives are still there
    - 4. Right now there is a different between the company and the stock price
        - a. Price is guaranteed to be wrong
        - b. However, this is a bit of a bi-modal outcome

            i. Either the stock goes to $0 or $60-$75
                1. Would not have chosen this fight if they had known in advance
                    a. They will avoid these types of situations in the future
    ii. Markel
        1. Was suspicious of Jack Welch
            a. Was not his favorite leader
            b. Too much leverage in the insurance business worried him
            c. But the core GE stuff such as power generation is still good
        2. Operating within MKL's core competency has been re-emphasized
            a. If they had known it was going to be this complicated they would never have gotten in

q. Questioner: Marcelo Lima- Why not buy LEAPs on GE due to the bi-modal outcomes?
    i. Gayner
        1. At $8-$12 a share GE is a LEAP
            a. A leap of faith more like
        2. Right now meat and potato companies can be bought at prices we have not seen in years
            a. You can build 70-80% of your portfolio with these solid companies
            b. The rest of the portfolio you use to buy leaps like GE

r. Questioner: Please comment on your policy on loss reserves and give us an idea of your current liquidity situation in the case of a large catastrophe
    i. Markel
        1. (2nd part first): Large part of the investment portfolio ($1.1B) could be liquidated if a large catastrophe loss occurred
            a. Their exposure to any catastrophe loss is well below this figure
        2. Getting reserves right is critical
            a. Can't price for tomorrow if you don't estimate your needed reserves right
                i. You can be either too conservative or too optimistic
                ii. They like to pick a number that it way more likely to be redundant than deficient
                    1. Don't want a midpoint number, they want a margin of safety
                    2. Leads to a conservative view on pricing as well
                    3. Leads to a focus on long term investments
                        a. Need solid, secure fixed income investments to protect against loss reserve deficits
        3. Industry as a whole has been bleeding loss reserves down
            a. Current book has a combined ratio above 100%
                i. Many companies are benefitting from previous redundancies that bring the aggregate combined ratio below 100%
                    1. Not true at MKL since they are always conservative

s. Questioner: Why is MKL holding so much cash?
    i. Gayner
        1. They are concerned about inflation
            a. Don't know when it will come

b. Carrying more short term securities than before
    i. Expecting an interest rate spike
        1. Does not want to own long term bonds
            a. "Last thing we want to own.."
                i. Want to own businesses with pricing power
c. Not earning much on their cash but they want to preserve the optionality that comes with holding cash

t. Questioner: What is the thesis on Diageo?
    i. Gayner
        1. It fits the 4 criteria they look for:
            a. Profitable business with a high return on capital
                i. Return on total capital is their preferred metric
            b. Run by honest, talented people (weigh those traits 50-50)
            c. Has positive re-investment dynamics
                i. Earns a high ROC and can re-invest at that rate
                    1. If they can't re-invest at that rate then they pay dividends and buy back shares
            d. Priced fairly
                i. Look for businesses in which 5-10 year shareholder returns mirror the returns provided by the business
                    1. All comes down to what you have to pay

u. Questioner: What is the impact of government actions going to be on the financial industry?
    i. Gayner
        1. Gov't is a bigger part of business than before
        2. He is worried about gov't action
        3. You can connect the dots between the growth of FNM and FRE and the recent turmoil in the mortgage industry
            a. Gov't involvement pushes away private business people
        4. They now ask the constant question:
            a. How could the gov't screw this business/industry up?
                i. They missed medical company opportunities over the last few years as a result of this fear
        5. The whole world is now a bank stock
            a. Nothing works without the banking industry
                i. Problems will eventually get solved but it will take time

## TO OUR BUSINESS PARTNERS

We are pleased to present you with this year's annual report. During the course of this letter, and in the body of the attached financial report, we hope to fully describe our 2009 results, our progress on important operational and financial objectives during the year and our outlook and goals for the future.

While the tangible results we speak of in this letter will be discussed in financial terms, another important dimension exists at Markel. Namely, an organization filled with talented and dedicated individuals. Throughout the period of financial crisis, and in dealing with massive internal changes within our organization, you can be proud of the fact that the people of your company acted with integrity, dedication and skill at every turn.

All of us commit ourselves to the long-term success of Markel. Our Company consists of a corps of professionals who are proud of our history and achievements. We all look forward to building our culture and record of success for the next generation.

We enjoy a profound advantage by embracing a long-term horizon at Markel. We run and operate this business with a view of years and decades as opposed to quarterly and annual comparisons. We think that stands as a unique advantage in today's business world, and we intend to make the most of it. We use this freedom to make long-term decisions to build the value of this Company and your holdings over time. We appreciate our shareholder partners and the role you play in helping us maintain a culture of long-term business excellence in the face of a very short-term oriented world.

## 2009 RESULTS

Markel Corporation continues to enjoy an outstanding record of financial accomplishment. Over the years, we've adapted to whatever conditions we faced and found ways to grow the value of your

| *(in millions, except per share data)* | **2009** | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|---|---|---|---|
| Gross written premiums | **$ 1,906** | 2,213 | 2,359 | 2,536 | 2,401 | 2,518 | 2,572 | 2,218 | 1,774 |
| Combined ratio | **95%** | 99% | 88% | 87% | 101% | 96% | 99% | 103% | 124% |
| Investment portfolio | **$ 7,849** | 6,893 | 7,775 | 7,524 | 6,588 | 6,317 | 5,350 | 4,314 | 3,591 |
| Portfolio per share | **$799.34** | 702.34 | 780.84 | 752.80 | 672.34 | 641.49 | 543.31 | 438.79 | 365.70 |
| Shareholders' equity | **$ 2,774** | 2,181 | 2,641 | 2,296 | 1,705 | 1,657 | 1,382 | 1,159 | 1,085 |
| Book value per share | **$282.55** | 222.20 | 265.26 | 229.78 | 174.04 | 168.22 | 140.38 | 117.89 | 110.50 |
| 5-Year CAGR in book value per share[1] | **11%** | 10% | 18% | 16% | 11% | 20% | 13% | 13% | 18% |

[1] CAGR—compound annual growth rate

Company. This year continues that longstanding tradition of long-term financial growth. We also continue the tradition of adapting, growing and changing as necessary to continue to produce excellent results over time.

The world does not stand still and neither do we. In 2009 a whirlwind of intense activity took place at Markel, and we look forward to reporting the developments to you as partners in our enterprise.

As to the headline numbers, during 2009 our underwriting operations produced a combined ratio of 95% on earned premiums of $1.8 billion. Our investing operations produced a total return on the portfolio of 13.2% with equity returns of 25.7% and fixed income returns of 9.8%. Combining underwriting and investing, our book value per share grew 27% from $222 per share to almost $283 per share.

While no single measure captures all of the value creation at Markel Corporation for its shareholders, we believe book value per share works as the best proxy. Over longer and more meaningful periods of time, such as 5 and 10 years, book value per share grew 11% and 15%, respectively. We produced these results during periods when investors in general earned low or negative returns.

The year-end 2009 book value per share of approximately $283 represents an all-time high. Our 20 year chart displays the progress of this and other financial measurements. To generate these returns despite the unfavorable fundamentals of a decade-long drought in the investment markets and a multi-year softening in the property and casualty insurance markets makes us happy. We hope the same holds true for you.

Since our public offering in 1986, we've grown the book value per share at a compound annual rate of 21.2%. This compares favorably to the growth of the S&P 500 of 9.3% over this time and stands as one of the better records in today's business world.

While we enjoy reporting these numbers and the balance of the financial figures in the rest of this report, they don't begin to describe the positive changes underway at Markel. To give you some sense of last year, here is a report on our 2009 "to do" list.

## 2009 "TO DO" LIST & PROGRESS REPORT

**One Markel**

Our One Markel initiative represents a fundamental restructuring of our Excess and Surplus

| 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 | 1990 | 1989 | 20-Year CAGR[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1,132 | 595 | 437 | 423 | 414 | 402 | 349 | 313 | 304 | 406 | 412 | 44 | 21% |
| 114% | 101% | 98% | 99% | 100% | 99% | 97% | 97% | 97% | 106% | 81% | 78% | — |
| 3,136 | 1,625 | 1,483 | 1,410 | 1,142 | 927 | 622 | 609 | 457 | 436 | 411 | 79 | 26% |
| 427.79 | 290.69 | 268.49 | 257.51 | 209.20 | 170.95 | 115.45 | 112.55 | 84.64 | 81.77 | 77.27 | 14.54 | 22% |
| 752 | 383 | 425 | 357 | 268 | 213 | 139 | 151 | 109 | 83 | 55 | 60 | 21% |
| 102.63 | 68.59 | 77.02 | 65.18 | 49.16 | 39.37 | 25.71 | 27.83 | 20.24 | 15.59 | 10.27 | 11.69 | 17% |
| 21% | 22% | 23% | 26% | 26% | 31% | 17% | 25% | 34% | 35% | — | — | — |

Lines business. The goal and objective of One Markel is simple. We want to make Markel easier to do business with, and we want to offer more of our products to more of our customers through our wholesale partners.

We seek to accomplish this goal by empowering our five regional offices to offer the entire line of Markel products to their wholesale partners. The regional offices are primarily responsible for underwriting, marketing, sales and customer service in the One Markel model.

At the same time, we strengthened and better organized our product line underwriting organization so that we can support the regions by providing specialized underwriting expertise wherever and whenever a customer needs it. The product line group, led by our Chief Underwriting Officer, retains responsibility in the One Markel model for product development, underwriting guidelines and authority and pricing. It also supports the regions in our marketing and sales efforts and helps underwrite more complex risks.

Prior to One Markel, our business units acted largely as independent silos. Often they operated with unique underwriting, marketing, information technology and administrative approaches. While we always centralized critical functions such as actuarial reviews, investments and balance sheet responsibility, we didn't integrate the underwriting and marketing efforts throughout the organization.

This legacy stems from our history of acquisitions of companies located in different areas. This approach was successful in building the financial results of the company for decades; however, it did not support scaling up and growing beyond a certain level. As Markel's product offerings widened, we realized we needed more effective ways to distribute our products. Problems such as difficulties in cross-selling and inadvertent competition between business units demonstrated a need to fundamentally alter our approach. Those challenges, along with our desire to increase the value of the Company, to more fully utilize our underwriting talent and expertise, to enhance the Markel brand and to create opportunities for our current and future colleagues, demanded a change to a new structure.

With One Markel, each regional underwriter carries sales and underwriting responsibility and authority. They enjoy access to all of Markel's wholesale products regardless of their location. Each product line group now carries the responsibility for the underwriting results of their products throughout the entire organization. Finally, and most importantly, each of our wholesale clients now connects with one Markel team, located in its region, who can deliver the full menu of Markel wholesale products.

It is impossible to overstate the degree of change this represents to our previous way of doing business. While any change such as this involves risk and fear of the new and unknown, the world we face changed, and we needed to adapt and move forward appropriately.

The important good news that we can share with you at this point is that the transition has gone well. We moved to the new model in all five regions in March of 2009 after running a prototype in our Mid South region for six months. This was nine months ahead of our original schedule. As you would expect, we experienced some bumps in the beginning. We wish to thank all of our wholesale business partners who worked with us and showed great patience as we dealt with transition issues. Due to their continued support, the Excess and Surplus lines segment was able to produce a solid 96% combined ratio in 2009.

While the current soft market conditions obscure the financial benefits of this simple yet powerful business structure, we can see from submission counts and customer feedback that we are on the right track. This is what our customers wanted and we are delivering it. We are confident that this change will produce meaningful opportunities for profitable growth when the property and casualty insurance cycle hardens.

**Atlas**

Atlas is our name for the systems and business process transformation that will ultimately support the One Markel business model. The goal of Atlas, like that of One Markel, is simple. The Atlas project should deliver the information systems and business processes we need to smoothly and seamlessly serve our customers and manage the insurance operations of Markel. For our customers, we need to offer easy online access to Markel and its products. Operationally we need to account for and manage the flow of business. Even more importantly, we need to use the information we gather to make better risk selection, pricing and marketing decisions every day.

With Atlas we will have unified systems to handle such operational functions as underwriting and policy issuance, claims, billing, agency relationship management and reinsurance. We also will operate with a centralized shared services capacity that should increase our operational speed, effectiveness and efficiency.

In 2009 Atlas began to deliver some of the individual projects to specific areas within Markel. For example we implemented the first phase of the agency management system, which will help us move closer to our customers. We also reorganized all of our administrative functions into shared services groups. This reorganization is already paying dividends in the form of simpler, more efficient and effective workflows throughout the Company. Finally, we made significant progress in establishing and documenting business requirements and have begun to build the systems.

Throughout 2010 the individual deliveries should continue. By the end of 2012, the project should be largely complete and functional throughout our Excess and Surplus Lines operations. 2010 will continue to show higher net costs for the Company as we complete the project. We expect that during 2011 we will be incurring lower costs for Atlas, and we will be operating more efficiently. The full implementation of Atlas will allow our organization to provide and manage greater volumes of business at lower costs.

Atlas is the most mammoth business systems and process project we have ever undertaken at Markel. In last year's report, we estimated that third-party vendor costs for Atlas would be approximately $100 million. Total costs were estimated at $160 million last year. Mostly due to a better understanding of the effort required to successfully deliver the project, we now believe that third-party vendor costs will be approximately $140 million and the total cost will be approximately $190 million. We are completely committed to the success of the Atlas project and will continue to look for ways to deliver the anticipated benefits at lower costs. The good news is that we have only spent approximately one-third of the total estimated cost to date and have opportunities to reduce costs further. We are pleased to see the early signs of success, and we look forward to continuing to report to you on the progress of this important project.

**Markel International**

Markel International produced a 91% combined ratio and $52 million of underwriting profits in 2009. Markel International has now produced underwriting profits in two of the past three years, missing only in 2008 as a result of hurricane losses. Immediately after our acquisition of Markel International in 2000, major reorganization and modernization efforts began. These efforts were not unlike those we are implementing in the United States today. Approaching the ten-year anniversary of its addition to the group, Markel International stands as one of the crown jewels of Markel.

Markel International's gross premium volume was $641 million, or 34% of the total gross premium volume at Markel in 2009. In contrast to the U.S. domestic market, the international market currently enjoys slightly more rational pricing and greater growth opportunities. We expect additional increases in the globalization of our business in the future.

During 2009 Markel International completed the acquisition of Elliott Special Risks in Canada. Markel International has done business with Elliott and its principals for over ten years. Elliott is one of the premier specialty insurance underwriters in Canada, controlling approximately $90 million of specialty professional liability and general liability business. This acquisition will allow us to meaningfully increase our Canadian business as we convert Elliott's writings to Markel International. In addition Elliott gives us the opportunity to cross-sell many of our existing product lines in Canada. We wish to welcome our new associates at Elliott to the Markel family.

In addition to Canada, Markel International has a network of offices in Spain, Singapore and Sweden. We also write insurance in over 150 countries around the world through brokerage relationships. We expect additional opportunities in the future to grow in markets such as India, China and Southeast Asia. Through Markel Syndicate 3000, Markel International is part of the Lloyd's market. Being part of the Lloyd's franchise provides regulatory and licensing advantages and efficiencies we will need as Markel International continues its geographic expansion.

**Specialty Admitted Insurance**

Markel Specialty produced a 99% combined ratio in 2009. In this division, we provide insurance directly to the consumer and to retail customers in various niche markets. Examples include children's summer camps, equine risks, motorcycles and boats, health and fitness clubs, student health, pet health, wedding insurance and other unique insurance coverages. We can design specific insurance products that meet the insurance needs of these unique risks. We often market our products in partnership with industry trade groups or affinity groups and include loss and safety engineering, as well as best practices, to reduce losses (and expenses) for our customers.

We enjoy a higher ratio of renewals in our specialty area compared to other areas at Markel, and have a reputation of industry leadership in many of our products. The stability and recurring nature of these insurance products provides a solid foundation and platform for growth in coming years.

In 2009 under the leadership of Mike Crowley, we increased our emphasis on providing specialty insurance solutions to the broader insurance markets. Our goal is to grow our retail and direct market share without disrupting or competing with our existing strong wholesale relationships. We also have increased our emphasis on sales and marketing to continue to grow this franchise. We expanded our product offerings with additional lines such as political campaign coverage and excess flood coverage in 2009. We also added a few select acquisitions of books of business and talented insurance professionals.

**Markel Ventures**

During 2009 we expanded our operations of non-insurance subsidiaries with the acquisition of Panel Specialists, Inc. (PSI) and Ellicott Dredge Enterprises. PSI provides laminated furniture products primarily to the college and university marketplace and to hospital and health care related sites. Ellicott manufactures dredges for transportation, mining and water management applications. Ellicott dredges were used to build the Panama Canal in 1907, and the company does business all around the world.

These two additions join our existing holdings of AMF Bakery Systems (a leading manufacturer of bakery equipment systems), which we acquired in 2005, and ParkLand Ventures (an owner and operator of manufactured housing parks), which we formed in 2008.

Beginning with the 2009 annual report, we will provide additional financial information on these businesses as they have grown to represent a meaningful aspect of Markel Corporation.

Strategically we believe the ongoing development of Markel Ventures will create value for Markel. All of these companies fit our longstanding investment discipline. As is the case in what we seek in our portfolio of publicly traded businesses, these businesses are profitable, with good returns on capital, they are run by management teams with equal measures of talent and integrity, they will use their profits to either grow their existing business or return the cash to Markel and we acquired them at fair prices.

As time goes by, Markel Ventures should assist us with several goals. First the businesses themselves have historically earned, and should continue to earn, excellent profits. They are all market leaders in their industries and enjoy a history of good returns. They provide basic goods and services that people need. As they grow over time, the profits they produce will accrue directly to Markel and benefit shareholders accordingly.

Secondly we can reinvest capital within the individual units or apply it elsewhere within the Markel Corporation structure as we choose. This power as a majority owner is very different than our position as a minority shareholder in a public company, as is the case in the remainder of our equity portfolio.

Finally ownership of these businesses will provide Markel with earnings and cash flow that are distinct and separate from our insurance holdings. This is a nuanced but important point. During times when Markel stock is selling for low valuations, financial markets and the regulatory and rating agency overseers tend to be very skeptical of companies repurchasing their own shares. All of the insurance regulators and rating agencies want more, not less, capital in insurance company subsidiaries. With non-insurance businesses held by Markel Corporation at the holding company level, we now will have cash flows that are independent of our insurance operations that create more of an option for us to deploy capital aggressively during inevitable stretches of difficult times. Purchasing power from having unrestricted cash to use during environments of low prices should enable us to increase the value of Markel in a unique way over time. Very few companies are in a position to follow or implement this strategy. We will make the most of our opportunity.

**Management Development**

Our goal is to make sure that Markel is immortal despite the fact that none of us enjoy that status. As such it is critical for the long-term health and development of your Company that the management team is refreshed and renewed continuously. Some of this renewal comes from existing managers taking on new roles and responsibilities. Some comes from the addition of new people into our organization.

During 2009 the changes in our business approach, the acquisitions of non-insurance subsidiaries and the turmoil in financial markets allowed us to aggressively strengthen the management team. Mike Crowley joined Markel to head the specialty insurance operations of the Company. Mike brought a long record of success and accomplishment in the insurance brokerage world to us, and his leadership of several marketing and new product initiatives should provide us with meaningful growth opportunities over time.

Britt Glisson moved into the role of Chief Administrative Officer of the Company. He leads the Atlas project and the shared services operation crucial to the One Markel approach. William Stovin and Jeremy Brazil assumed the leadership of Markel International. Gerry Albanese, after five years leading Markel International, returned to the United States to become Markel's Chief Underwriting Officer and lead our product line group. John Latham recently assumed responsibility for leading the sales and marketing efforts in the newly established regional offices.

Debora Wilson joined our Board of Directors in 2009. Debora oversaw the successful development of The Weather Channel at Landmark Communications. We are thrilled to have her perspective on building new businesses and managing the people and resources needed to accomplish the goal of profitable growth. We are also pleased to welcome Darrell Martin, our former Chief Financial Officer, back to our Board, where his financial expertise and his knowledge of the Company and our industry will be extremely valuable.

Countless other individuals assumed new roles and responsibilities during the year. Space prevents us from listing everyone, but an accurate and full report would include almost everyone in the Company.

Change often invokes fear of the unknown and a nostalgic longing for the way things used to be. That is a backward looking and futile approach that will produce disappointing results over time. The world spins and things change. As the senior leaders of Markel, we could not be more proud of the way our people have responded to the changes within Markel and throughout the entire marketplace.

Almost everyone in the Company has new responsibilities and new tasks. Throughout the year, the willingness and sense of challenge and adventure that our people have brought to the task has been gratifying. This spirit makes us optimistic that the organization will continue to respond, adapt and grow as new challenges and opportunities arise.

Some change, however, is not positive. It is with much sadness that we recognize the 2009 passing of Les Grandis, a member of our Board of Directors for over 20 years. As both a board member and as outside legal counsel, he provided sage wisdom, experience and insight during an important part of the Company's history. We are grateful for his service to the Company and his contributions to our growth.

**New Products**

With the addition of a Chief Underwriting Officer and the formation of product line groups, we are well positioned to add products and expand and upgrade existing products.

During 2009 we expanded our equine offerings by adding a team of experienced equine professionals at Markel International. We also hired experienced transportation and property insurance professionals to lead these product line groups.

We plan to re-enter the directors and officers liability market. We also added an experienced and successful team of underwriters to enter the trade credit risk market during 2010.

Finally we formed a product development team to help our Chief Underwriting Officer and product line leaders develop new product opportunities.

While the current soft property and casualty insurance market obscures our progress from these initiatives, we are excited about future growth as marketplace conditions stabilize and improve.

Although we completed many items on our "to do" list in 2009, a new list, with new opportunities and challenges, hangs on our refrigerator as we move through 2010.

## INSURANCE MARKET COMMENTS

In 2009 our insurance operations produced a combined ratio of 95% on total earned premiums of $1.8 billion. While profitability improved, gross premium volume declined 14% from last year due to lower insurance market prices, depressed demand for insurance from the slower overall economy and governmental actions, which kept insurance industry capacity and supply intact when it would otherwise have failed and been withdrawn from the marketplace.

Our response to the difficult market conditions was as follows. One, we quickened the pace of our reorganization to One Markel as we believe that will produce growth opportunities both from increasing our penetration among our existing customers and allowing us to more easily seize opportunities. Two, we supported the growth of our international operations where more opportunities exist and irrational competition is not quite so prevalent. Three, we increased our emphasis on new product development. And four, we acquired Elliott Special Risks and several other smaller niche product lines.

We expect these actions, as well as the efficiency and responsiveness we are building into our organization, to allow us to make the most of the current environment and to produce reasonable underwriting results. We also expect these actions will enable us to handle meaningful increases in business volumes, at low incremental operating costs, when the insurance cycle improves.

We do not make any predictions as to when this will occur. We remain convinced, however, that sub-optimal industry profitability (i.e. underwriting losses) and AIG's government-sponsored exemption from free market forces must end. When this happens, we expect pricing for property and casualty insurance risks to improve meaningfully. We will be ready to make the most of that environment when it occurs.

## INVESTMENT COMMENTS

Following the cataclysmic events in world financial markets in 2008, we enjoyed a meaningful rebound in 2009. The overall investment portfolio produced a return of 13.2% in 2009 with equities up 25.7% and fixed income returns of 9.8%.

We are very pleased with these results. Our strong balance sheet allowed us to weather the fierce storms of 2008. We endured and kept the losses in 2008 to a minimum despite the most difficult investment markets we've ever encountered. Keeping ourselves largely whole through the storm, coupled with our strong and highly liquid balance sheet, enabled us to continue to invest proactively in 2009.

During 2009 we steadily and consistently added funds to our equity portfolio. At year end, our exposure to publicly traded equities remains lower than our historical averages at 17% of the investment portfolio. While we increased our holdings during the year, we remained conservative and liquid due to continued softness in the insurance marketplace. When insurance market pricing firms and our premium writings grow, we will accelerate the pace of our equity investing.

In our fixed income operations, we enjoyed the rebound in pricing that occurred on our holdings of corporate debt securities. This area of the portfolio suffered the most during the financial crisis. The strength of our balance sheet allowed us to maintain our positions for the rebound. Going forward we will continue to allow the proportion of corporate debt securities to diminish as a percentage of our fixed income holdings. The job of our fixed income portfolio is first and foremost to secure and protect the insurance liabilities of Markel. We will seek additional returns over and above those offered by government-backed securities only with the funds we would willingly and prudently allocate to our equity portfolio.

Our equity portfolio allocation has and will continue to include publicly traded equities, corporate debt with equity like returns and majority-controlled non-insurance subsidiaries.

Protecting the balance sheet is always the most important goal in our investing (as well as in our insurance) operations. Great pricing opportunities in the financial markets, such as we saw earlier this year, mean absolutely nothing if we don't have the balance sheet and appropriate liquidity and cash flows to take advantage of them. Consequently we will always err on the side of conservatism to make sure we have the balance sheet strength to act in the long-term best interests of the Company.

We saw the value of maintaining our balance sheet strength over the last two years. Many previously blue chip financial institutions have been wiped out. Others exist only due to government influence and largesse. Their shareholders suffered total or near-total wipeouts. At Markel, management's investments in the Company represents the bulk of our personal net worth. We will never operate in such a way as to endanger the firm.

## SUMMARY

We look forward to looking back on 2009 in the rear view mirror. It was a historic year of transformation at Markel. We survived the worst financial market storms seen in modern history. We earned a solid underwriting profit in a difficult insurance market. We fundamentally altered the basic operations of the Company with the move to the One Markel business model and the Atlas project. We protected our balance sheet during the crisis (by not being highly leveraged or hyper-aggressive before the crisis). We made substantial positive investment decisions during the year and enjoyed the good returns earned in our publicly traded equity and fixed income portfolios. We expanded our holdings of non-insurance operations to the point where they have now become meaningful to our overall performance.

While we would all prefer to be operating in an environment where insurance prices are going up, financing is easily available and economic growth is a given, we recognize that we are not. The world is not going to change to accommodate us, so we change to accommodate it.

We are faster, leaner and smarter as an organization than we have ever been before. We have talented, hard-working and dedicated associates throughout the Company. We have a healthy mix of proven veterans and younger managers with experience, energy and ideas. We've demonstrated a resilience and flexibility that produced success at Markel, while other firms failed. We gratefully thank our associates, customers and shareholder partners for working through and supporting these changes.

We pledge that we will compete effectively in whatever circumstances the future holds. The world is a big place, and the scope of our organization is wider, more talented and more nimble than at any time in the past. We look forward to continuing to build the culture and adding to the record of accomplishments at Markel.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*Vice Chairman*

Steven A. Markel
*Vice Chairman*

Thomas S. Gayner
*Chief Investment Officer*

Richard R. Whitt, III
*Senior Vice President and Chief Financial Officer*

**Markel Annual Meeting- Sunday, May 2nd, 2010**

**Speakers:**
Steve Markel (CEO)
Tom Gayner (CIO)

**Tom Gayner:**
Reminded us that that this is the 20th Year that the Markel (MKL) meeting has been the same weekend as the Berkshire Hathaway (BRK) Annual Meeting

**General Comments:**
**Steve:** The current state of affairs if you look at the insurance markets objectively: not a pretty time to be running a P&C business. There is more capital chasing fewer premium dollars and pricing has been very stressed. All in all it is a tough environment. Renewal rates are coming down.

Having said that he thinks Markel is in the best position it has been in years. Why? Markel's great strength is its 25 year, long term view. It makes it easy to be optimistic when you have a long term view and can look past short term issues. The metrics of the business will allow them to generate high rates of return. He believes that they can write insurance with combined ratios that are profitable. This environment will be tough for their competitors as well. So, there should be a lot of opportunities on the private equity and insurance sides. He said that deals are going to happen and they are very enthusiastic about the potential. They think they have the model in place to take advantage of the stressed environment.

The economic scene is starting to see some recovery but it is not what it was 4-6 years ago. Insurance premiums often follow economic conditions and since the people they insure are not as active in business, MKL's premiums are down.

A lower interest rate environment leads to lower returns on the investment portfolio. They are not in the mood to invest in long terms bonds that could get hammered if interest rates go up (a sentiment that was echoed by Buffett at the BRK Meeting). They are afraid of inflation. They don't know when it is going to come about but they think it will.

**Question 1:** Bill Berkeley [of W.R. Berkley Corporation (WRB)] recently said on a conference call that he expects a turn in P&C pricing by end of 2010? Is he right?

**Steve:** Said that if he had to bet on the over-under, he would take the over. Steve Berkeley was very optimistic and he hopes he is right. But he is skeptical.

**Question 2:** What would they have done differently last March (at the bottom of the market) if they could do it all over? How did they make decisions then?

**Steve:** Anytime there is a panic we all share in the fear that's around us. The smartest of us figure out how not to be too fearful, but you don't want to grab a falling knife. It is always tough to call the bottom. In the insurance business when stocks and bonds are falling, capital levels are falling too. So, to put money to work you need excess capital. Knowing how it all played out, they were much more conservative than they needed to be. However, if the bottom had been lower they would have been much less happy with the benefit of hindsight.

**Tom:** Steve was encouraging him to be more aggressive. But what Tom pushed back on was the mark to market of the capital accounts [meaning that as stock prices were falling so were their capital levels as mark to market asset values went down] and the soft market for insurance premiums. He would have fired both barrels (he said he was firing one barrel) if it had been a hard insurance market. They were buying and dollar cost averaging their way into a higher equity position and are still doing that today.

Pricing and valuation are important but behavior makes a professional investor rich or poor over time. The ability to continue to buy week in and week out is key. You have to able to pour money into things that are working and will work well. You also have to be able to sell what is not working. This beats timing the market every time. Insurance companies have regular cash flows so they get money all the time. Accordingly, dollar cost averaging creates a lot of wealth for them.

He mentioned that the #1 mutual fund was run by Ken Heebner (CGM Focus Fund) during the decade last. The fund made 18% per year. However, the most astonishing fact is that the average shareholder in that fund actually lost 11% per year. What that means is that people were trying to time the market and lost money consistently. Thus, it's better to find partners that share MKL's beliefs even though you can't necessarily control your shareholders. You have to put yourself in position to succeed by avoiding losses and failures.

**Question 3:** Does MKL have automatic shareholder investment plan?

**Steve:** Not right now but they would look at it if enough people were interested.

**Tom:** Because they don't pay a dividend and instead invest in the business or the portfolio they actually do have an automatic 100% dividend reinvestment plan.[Laughter]

**Question 4:** When it comes to the purchasing of private operating companies, with MKL, what do you feel that you can bring to the private business owner that is an advantage over other owners? Where are you looking for these opportunities (Specifically, in reference to the MKL Ventures initiative)?

**Tom:** A year ago he made the case to Steve that the crisis had presented a huge opportunity for MKL. Agreed with Buffett that there are three categories of buyers to sell private businesses to:
1. Private equity/LBO: This is a disruptive process that adds a lot of leverage. This is the process to choose if you want the highest dollar value. But you have to know that you will be sold again soon.
2. Strategic buyer: Someone already in that business. But this buyer can come in and slash headcount and fold it into their company. If you love your business then this could be very unpleasant.
3. Someone who believes you run a great business: MKL offers permanent capital. Do the same deals as BRK does--just with fewer zeros.

Where do deals come from? First they bought AMF Bakery in 2005. It was located in Richmond (where MKL is located) and the CEO did not want to sell to a PE firm because he had been with a firm that had been bought by a PE firm previously. He threw himself in front of the bulldozer with the intent to sell to MKL. In 2006-07 they still wanted to do these deals but they did $0 in business. Other people were willing to pay too much since financial markets were still going wild. In 2007, a lawyer from the AMF deal called and suggested another client. From that call they linked up with Parkland Ventures, a business that manages mobile home parks. This company had management capabilities but did not have the necessary capital. MKL had capital and together they have been growing. There is a long of runway for this business.

Next, they bought PSI, a company in the dorm room furniture business. This is a specific niche and is as much of a logistics business as a furniture business. This deal came from another Richmond connection. Finally, was the Ellicott Dredge company deal. This company does business all over the world as the leading manufacturer of small dredges. They are the ones who dredge the Panama Canal. The family members needed liquidity, wanted the company to be on permanent footing, and ended up in good hands with MKL.

When people see that you can do these deals, they begin to understand what you are looking for. MKL promotes the ideas of love and permanency. This is a good, self reinforcing mechanism in terms of selection of potential companies. The phone is actually running of the hook now.

**Question 5:** How did MKL's culture come about?

**Steve:** Warren and Charlie mentioned that shareholders are a powerful force in terms of company culture. Steve agrees with that when it comes to MKL as well. MKL has created a very successful culture, partially by cultivating long term and loyal shareholders. There is no question that the pressure of going public is severe. Wall Street analysts are often seen as a firm's actual shareholders by company management teams. The analysts ask these stupid questions and the management teams waste all of this time catering to sell-side analysts. But, the ultimate owner of the stock is a mutual or pension fund shareholder. Analysts are not your shareholders. There is a huge distinction between actual shareholders who make decisions and analysts.

MKL only raised $5M when they went public, A lot of the people who bought in were employees and associates of MKL. When you think about who your shareholders are, in this case their shareholders were their friends and families. Then you have to think about what a manager is entitled to and what a shareholder is entitled to. They decided early on that the shareholders should get the benefit of the doubt. They are shareholders as well so the interests are aligned. Building wealth was more important than building income. Tom always said (quoting the movie The Field of Dreams), if you build it they will come. So, they decided not to make any promises-- just demonstrate success and investors will buy in. Under-promise and over-deliver is their motto.

The value of renewal retentions is incredibly important at places like GEICO. The averaged insured stays around for 8-9 years. For MKL, they want to get customers to stay with them for 3-6 yrs. Retaining existing customers is certainly better than trying to get new policy holders each year. Along the same lines, why would you want to go out and cultivate new shareholder each year? It's a lot smarter to stick with the same shareholders. The average life expectancy of the Fidelity insurance analyst is only 6 months. They think it is crazy to have to tell the story over and over again to someone who is either not listening, not going to be there, or has no interest in owning the stock for a long period of time. The truth is that being in Omaha the first weekend in May is a great place and time to look for shareholders.

How exactly do they retain customers? They get a customer and they treat him/her well in hopes of keeping him/her for a long time. For example, MKL has a children's summer camp business. In fact, they insure 50% of the children's summer camp businesses in the US. It is not a huge revenue generator but people stay with them for 10 years. But, for something like earthquake insurance they get renegotiated each year. They prefer smaller accounts where they know their customers and can keep them loyal.

**Question 6:** Unlimited government capital has gone to one of their competitors (AIG). How is that going to play out? Also, do they have any volcano exposure?

**Steve:** Steve said he had no idea how the AIG situation is going to play out. The AIG insurance sub has been re-branded Chartis and appears to be doing $40B worth of premiums each year. This is about a 10% market share. The government was going to spin it off but that has been shelved for now. The truth is that AIG accepts larger accounts and MKL looks for smaller accounts. So, they don't go head to head each day. But sometimes MKL drifts up and AIG drifts down so they do compete a bit. The truth is that AIG is more disruptive when it comes to larger insurance companies.

Steve was not aware of any direct exposures to volcanoes.

**Tom:** A few years ago they saw competitors doing irrational things and thought that one day these companies "would run out of money to run out of." Well, they eventually did. This will also be true for the various taxpayer funded ventures. MKL will just compete day to day. We can't forget that UPS and Fed Ex have beaten the post office (USPS) because they have better and more efficient operations. So, MKL should be able to compete with government-influenced businesses as well.

**Question 7:** Do they have a current opinion on large financial companies?

**Tom:** Steve often tells him that some of his ideas are the dumbest he has ever heard. Then they switch positions and argue the other way. Steve likes arguing and Tom has adapted. They have argued about financials a lot and they have minimal exposure to these companies (excluding BRK of course). They think there are some that are OK and that some will do well. But they like companies with no debt. Crooks often use a lot of debt. If you have a 100% equity company, then you are likely dealing with honorable people because they are using their own money. Financial institutions are highly leveraged. Tom has been burned by high leverage and going forward he will be leery of high leverage. Systemically, he hopes that we are going to deal with the crisis. Specifically, he thinks we need to figure out ways to counteract the leverage that has to exist for the financial markets to work. As Buffett has said, if CEOs and directors had been personally liable then things would have likely turned out differently. He is expecting that we will figure out a way to align interests and make people more accountable when they run financial companies.

**Steve:** The MKL model is that they look at problem backwards. If you go through that process you have a better understanding of what's going on.

**Question 8:** When it comes to Markel Ventures, some investors would like to see more disclosure. How much capital has been deployed? Can you comment on some previous deals?

**Tom:** You will see more full disclosure since they have now crossed the realm of [accounting] materiality for MKL. Segment reporting disclosure will start in 2010 for MKL Ventures. In aggregate, they have roughly put $100M of capital to the set of companies and they expect $150M+ in revenue this year. They also are anticipating a double digit cash return from these businesses. These companies would be less expensive than public alternatives on price to earnings or any valuation metric.

To be able to have the controlling interest-- 2 things they need to control; CEO compensation and capital allocation decisions. It is a huge advantage when you can eliminate the agency problems that you have with public companies.

Owning these businesses gives them flexibility. For example, if you go through a 2008-like period again, the cash flows are not regulated by the insurance regulators and they can use cash in different ways than they can for cash generated from insurance industries.

**Question 9:** How is One Markel coming along?

**Steve:** They reorganized the wholesale side of the businesses and have given the 5 regional offices the entire MKL product suite. It has been a complicated process b/c people had to be moved around. They also had to add sales and underwriting personnel in a lot of markets. It has been an accounting nightmare and has created a lot of disruption When it is done the wholesale business will be operating more efficiently on one integrated system. MKL agents will have the ability to see all of MKL's products. People are becoming more conformable with their new positions and roles. This actually has been a good time to do a disruptive reorganization because the economy is down and the economy is struggling. Agents are starting to embrace it and people are starting to be more aware. It is a big project that a lot of people are focused on but it will be until next year that the entire system is up and running

**Question 10:** Regarding the run off marine business--would they get into this business again now? Are the competitors really exposed?

Steve: They shut down the marine business 18 months ago. They have no continuing exposures and have no loss from the recent spill. They do have a marine business in London. Losses will likely be the maximum of their policy loss exposure. MKL's share of that risk is probably going to be the max: $12-$13M. Luckily, they had very little exposure relative to other's market shares. Anyone who is near the risk will get sued-- deep pocketed people always get sued. The marine and energy business in London is very strong and they are hopeful that this is one reason that rates will firm.

**Question 12:** The Richmond bank (First Market) they invested in…what's happened to it?

Steve: Merged with Union Bank. They were a $1B bank and Union was a $2B bank. As a bank they are doing well, but banks in general are not doing well. They have a great opportunity in the Virginia market. They now have a much larger footprint combined. Should be a good match and hopefully will grow and be successful going forward.

**Question 12:** Is MKL going to create a new team for MKL Ventures?

**Tom:** Yes, they have already doubled the size. As the size and scale grows it will require a few more people that are not there today. They want to get the people who run the companies in MKL Ventures to meet one another. They hope a cross-pollenization dynamic can emerge. They already have succession plans for these companies in place. In any case they will remain a decentralized operation. Like BRK, they are not going to have a lot of operational personnel.

**Question 13:** Are the MKL deals usually stock deals? What percentage remains in the hands of management?

**Tom:** All the deals have been done with cash. They are not opposed to using stock if it suits someone's desire to defer a gain. The share count of MKL goes down each year through buy backs. But they want to keep the share count of MKL in control. They don't offer any stock options so they don't have share leakage. They are getting 80-100% ownership depending on the company in questions.

**Question 14:** MKL International has become the crown jewel of the organization. What are the opportunities there?

**Tom:** There are opportunities to grow. There is a big world out there. They are looking for offices all over the world. They have been able to prove that they can turn the corner and become profitable.

**Steve:** They acquired Terra Nova in 2000.. They spent a lot of time rebranding and reorganizing into MKL International. When they bought Terra Nova, it had 8 different Lloyd's syndicates that were competing against each other. Now they can market and sell all the products in a similar way. It was tough at first to inject the MKL culture in England. But, today, the fact that the London office embraces the MKL style is very obvious. At the end of last year the London team suggested that they buy a general agency in Toronto that they had been working with for years. The MKL International team put the deal together from the beginning to end and they closed the deal last year. A transaction like that does not have to be initiated in Richmond and that shows the strength of the MKL International franchise. They expect more deals to come through that pipeline.

**Question 15:** Have they made any changes for underwriters in terms of incentives and compensation (in terms of One Markel)

**Steve:** Most underwriters used to get compensated only based on underwriting profits. Now, it is sort of split between people who get some compensation for selling and others who get compensated only for actual underwriting. Everybody is still compensated based on underwriting profits but in the regional offices in which people are in charge of sales, there are some incentives to stimulate growth. This is an improvement but it does represent some change. Underwriting profits still drive MKL.

**Question 16:** What was the reason to enter the D&O (Directors and Officers Liability) business?

**Steve:** They hired a guy who is opening a new office for a D&O business. They got out of that business years ago in the US—only write some non-profit D&O. They brought on a guy they had known for a while and who had a lot of experience. Currently, they are in the midst of putting something together to write new business. He thinks that they could take advantage of a rising pricing in environment in D&O in the coming years. But, they may be early and this may not evolve into a meaningful chunk of business. At most they think it could be $10M in business per year. The expected claims coming from the financial crisis have not played out and at this rate they are not sure if that is ever going to happen.

# 2010

## To Our Business Partners

We are delighted to update you on this year's financial results, business activity and our outlook for the future in this annual report. We appreciate that you, as the owners of Markel Corporation, share our interests in building the long-term value of this Company. We also recognize that the relationship between the management team at Markel and our shareholders is uncommon in today's short-term focused world. We treasure this relationship as it allows us the unique opportunity to build this Company in a durable and profitable manner.

Every year, this report is our best effort to communicate with you about the operations and activities of your Company. We want to tell you everything about what we are doing. We are excited about the changes we've made at Markel in the last few years. We are optimistic about our future, and we want you to know as many details as possible about your Company.

We believe that the more you know about what we are doing, the more you will share our optimism and continue to support us with the capital and patience needed to accomplish our lofty goals.

While no single measure can ever really capture the total financial picture, we have historically reported to you the book value per share as a reasonable proxy for our performance.  By this measure, 2010 was a solid year of progress for Markel as book value per share rose to a new record high of $326.36, an increase of 16% from a year ago. Five years ago, book value per share was $174.04, and the compound annual growth rate since that time stands at 13%. Ten years ago, book value was $102.63 per share, and the compound annual growth rate over that period was 12%. You can see our year by year progress in the 20-year table provided below.

We expect to continue to rely on book value per share as the most important metric for measuring the progress of the Company as a whole.  In addition, the ongoing growth of our non-insurance operations contained in the Markel Ventures group, and capital management actions such as share repurchases, will mean that we may augment that statistic with other relevant measures. We will fully share with you the key measures that we ourselves look at to make and judge our business decisions.

| *(in millions, except per share data)* | **2010** | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|---|---|---|---|
| Gross written premiums | **$ 1,982** | 1,906 | 2,213 | 2,359 | 2,536 | 2,401 | 2,518 | 2,572 | 2,218 |
| Combined ratio | **97%** | 95% | 99% | 88% | 87% | 101% | 96% | 99% | 103% |
| Investment portfolio | **$ 8,224** | 7,849 | 6,893 | 7,775 | 7,524 | 6,588 | 6,317 | 5,350 | 4,314 |
| Portfolio per share | **$846.24** | 799.34 | 702.34 | 780.84 | 752.80 | 672.34 | 641.49 | 543.31 | 438.79 |
| Shareholders' equity | **$ 3,172** | 2,774 | 2,181 | 2,641 | 2,296 | 1,705 | 1,657 | 1,382 | 1,159 |
| Book value per share | **$326.36** | 282.55 | 222.20 | 265.26 | 229.78 | 174.04 | 168.22 | 140.38 | 117.89 |
| 5-Year CAGR in book value per share[1] | **13%** | 11% | 10% | 18% | 16% | 11% | 20% | 13% | 13% |

[1] CAGR—compound annual growth rate

The last five and ten years have seen challenging financial environments. The insurance markets in which we operate experienced increasingly competitive conditions and investment markets were treacherous. Despite these conditions, your Company substantially increased in value. We are pleased with these results and we hope you are as well. We look forward to building on this legacy in the years to come.

## Ch-Ch-Ch-Changes
### (with apologies to David Bowie)

Perhaps when we look back at 2010 in future years, we will smile knowingly at phrases like "unusual uncertainty" or "the new normal" that we all hear so much of these days. The future is always uncertain, and whatever conditions exist as time goes by are, by definition, "normal." For today though, the sense remains that somehow the degree of uncertainty and what normal looks like seem different than in previous eras.

In keeping with this sense of taking everything to warp speed as the overall environment shifted, we've implemented a series of dramatic changes at Markel in recent years. We've changed our basic business model of how we market and distribute insurance. We've changed the senior leadership team to assure continuity into the future. We've changed information technology systems and approaches to how we manage the Company. We've changed by adding to the countries and markets where we operate. We've even changed the scope of the businesses we operate with the addition of Markel Ventures.

As we've worked through these changes, one thing has not changed and will not change, namely, the Markel Style, which describes the values by which we operate this Company. Markel operates with integrity. We value our associates and our customers. We maintain a long-term view while operating our business, and we do not cut corners or take shortcuts to make current results look artificially better.

In addition to those values, which will not change, we expect the future to be guided by two fundamental business realities.

One - technological change will continue to occur at an increasing pace.

Our technological approaches must be fast, flexible and cost effective. Every decision we make must be reviewed in those terms to assure that it fits that model. Whatever solutions exist today will be different in the future, and we need to be able to turn on a dime to adapt to tomorrow's realities.

Later in this report, we will discuss our Atlas initiative and how we are adapting our approach to our information technology management process to reflect this reality.

Two - talented and honest people will do fine.

Despite whatever changes we face and however daunting they may seem at the time, everyone else faces them too. Everyone faces the same economic, regulatory

| 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 | 1990 | 20-Year CAGR[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1,774 | 1,132 | 595 | 437 | 423 | 414 | 402 | 349 | 313 | 304 | 406 | 412 | 8% |
| 124% | 114% | 101% | 98% | 99% | 100% | 99% | 97% | 97% | 97% | 106% | 81% | — |
| 3,591 | 3,136 | 1,625 | 1,483 | 1,410 | 1,142 | 927 | 622 | 609 | 457 | 436 | 411 | 16% |
| 365.70 | 427.79 | 290.69 | 268.49 | 257.51 | 209.20 | 170.95 | 115.45 | 112.55 | 84.64 | 81.77 | 77.27 | 13% |
| 1,085 | 752 | 383 | 425 | 357 | 268 | 213 | 139 | 151 | 109 | 83 | 55 | 23% |
| 110.50 | 102.63 | 68.59 | 77.02 | 65.18 | 49.16 | 39.37 | 25.71 | 27.83 | 20.24 | 15.59 | 10.27 | 19% |
| 18% | 21% | 22% | 23% | 26% | 26% | 31% | 17% | 25% | 34% | 35% | — | — |

and technological environments. No one gets to choose a different reality.

We compete all over the world for talented associates to serve our customers. If we attract and retain the best people through a combination of shared values and appropriate financial incentives, we will survive and prosper, and the value of your Company will grow.

## Financial Results

Total operating revenues rose to $2.2 billion from $2.1 billion, up 8%. Earned premiums were $1.7 billion compared to $1.8 billion a year ago, and the combined ratio for the year was 97% compared to 95% in 2009. Investment income totaled $273 million compared to $260 million in 2009, and other revenues were $186 million compared to $90 million a year ago.

On our balance sheet, total shareholders' equity rose to $3.2 billion from $2.8 billion, and debt to total capital declined to 24% from 26% in 2009.

We remain balance sheet oriented at Markel. We strive to make our loss reserves more likely redundant than deficient, and we err on the side of conservatism and maintaining the integrity of the balance sheet. This is a core value of Markel that will not change.

In our insurance operations, we operated at a combined ratio of 97% vs. 95% a year ago. This year's results were negatively affected by the Deepwater Horizon disaster in the Gulf of Mexico and the Chilean earthquakes, as well as heavier than normal expenses associated with our information technology initiatives. These two factors added two points to the loss ratio and three points to the expense ratio in 2010. We are pleased with another year of underwriting profitability, especially given the difficult market conditions in the insurance industry.

We also are optimistic that despite challenging overall industry conditions, we will continue to enjoy good results in our insurance operations.

During 2010, we took several steps to make that happen in our wholesale, specialty and international segments.

We promoted several proven executives to new positions of responsibility. For example, we named Gerry Albanese as Executive Vice President of Markel. In this role, Gerry oversees all underwriting functions of the Company.

We also promoted John Latham to President of Wholesale Operations and named new leaders in our Northeast and Southeast regions, as well as a new head of marketing for the wholesale operations.

We promoted Timberlee Grove to Chief Operating Officer of Markel Specialty. We also named new product line leaders in the Transportation, Architects and Engineers, Directors and Officers and Crisis Management disciplines.

We added to our longstanding presence in the equine insurance world with the acquisition of the American Livestock book, and we enjoyed the first full year of operations of the Elliott Special Risks operation in Canada, which we purchased in the fourth quarter of 2009.

All of these promotions and this activity have one goal in mind: Build the Markel brand for future growth and leadership. In the world of insurance, Markel stands for integrity, expertise and entrepreneurship. Our customers recognize our long-term commitment to solve their insurance problems and we look forward to building on that reputation all around the globe.

In our investment operations we enjoyed a fabulous year. Total investment return was 7.9% in 2010 with equities up 20.8% and fixed income up 5.4%. We remain optimistic about future returns from our equity investment operations. We continue to have more ideas than money, and that is a good recipe for future returns.

In our fixed income operations, we remain concerned about the likelihood of interest rates increasing from their current low levels. This began to happen somewhat in the fourth quarter of 2010 and, while we don't know when, we think that higher rates are on the way.

In preparation for higher rates, we've shortened the maturity of our bond portfolio over the last two years. As bonds have come due, we've replaced them with bonds that have shorter maturities. This has constrained our investment income, but we think that protecting the balance sheet from the big price drops that would occur on long-term bonds if interest rates rose is the right decision. We will continue to remain vigilant and only redeploy our capital to longer-dated bonds if we feel we are being paid adequately for assuming the risks of inflation and currency degradation.

## Insurance Industry Dynamics

Profitable insurance premium volume remained hard to come by in 2010. It is no mystery why this is the case. There is simply too much capital in the insurance industry compared to the risks that need to be insured.

While reliable statistics are difficult to pinpoint, we can hang some numbers on the capital issue and the supply versus demand situation. According to A.M. Best Company, total capital in the U.S. insurance industry at year end 2010 is approximately $550 billion. Total premiums for the U.S. insurance industry for 2010 are estimated to be approximately $400 billion.

While these are rough estimates and U.S.-based numbers only, they directionally describe the worldwide state of the insurance industry. Just as is the case at Markel, the insurance industry continues to be more global. As such, capital moves from jurisdiction to jurisdiction and can and will respond to insurance opportunities anywhere around the world.

Simply put, there is too much capital (supply) in the insurance industry relative to current demand for the industry to produce attractive overall returns on capital.

Over time, this situation will change. Insurance markets will harden and prices will increase. We do not know when, but we expect a combination of factors such as rising interest rates (which will diminish the values of the industry's investments), loss reserve deficiencies, share repurchases, dividends, merger and acquisition activities and catastrophes to dent and diminish industrywide capital levels.

We also would say that in addition to "too much capital" there is "not enough risk." The economic shock waves from the financial crisis in recent years have not passed through the system completely. Measures of economic activity remain constrained and risk is still kind of a bad word.

This will not remain true indefinitely. Growth outside the United States continues to occur at healthy rates as living standards around the globe rise. Historically, total insurance premiums grew at a rate slightly higher than GDP due to increasing sophistication, complexity and sense of liability. Risk has been suppressed in recent years and the demand for insurance suffered accordingly. As the entire world continues to advance economically, the demand for insurance should resume its upward path and help correct the current supply-demand imbalance.

A more vibrant level of economic activity creates more risk and more demand for insuring that risk. Recovery and an increased pulse of economic activity should improve the supply-demand balance for the global insurance industry.

Finally, one of the many perverse features of the insurance industry is the mislabeling of riskiness and capital adequacy. Right now, prices are falling and premium to surplus ratios are declining. This makes it look like the industry is more overcapitalized and less risky as it charges *lower* prices to assume the *same* risks.

When prices start to rise, premium to surplus ratios will rise and rating agencies, regulators and analysts will state that the industry is becoming riskier and less capital adequate as it charges *higher* prices to assume the *same* risks.

In short, this is idiotic.

Nonetheless, it remains the method by which capital adequacy and solvency is rated and regulated and we can't change it. This produces a leveraged effect where price swings are magnified and needless volatility occurs. Insurance prices accelerate both downward and upward during normal market cycles. While we all bemoan the current tough pricing environment for insurance, we are confident that this recurring cycle will recur yet again, and we will see accelerating upside prices in the future.

Despite the reality of current soft pricing and hypercompetitiveness, we can and are doing several things to propel economic growth at Markel.

First, our focus on specialty insurance products allows us to be among the first to serve new markets and new risks. We don't need extensive history and years of actuarial data to serve a newly emerging industry or a new type of risk. Our talented associates can use the technical tools available and combine those tools with business judgment to design and price insurance products to meet the needs of new customers and new businesses.

Second, while we are willing to significantly reduce writing insurance in specific areas when we believe that rates are inadequate, we can increase writings in these markets later when rates are more appropriate. This flexibility should help us to be out of the market when premium dollars are scarce and present when they are more abundant. As an example, we re-entered the market for directors' and officers' liability coverage in 2010 after having withdrawn from that market in the 1990's.

Third, as our capital base grows and our geographic spread of business widens, we can write more risks and higher dollar amounts of each risk. As an example, writing more energy business around the world enables us to write more energy business in the Gulf of Mexico due to the benefits of additional diversification.

Fourth, while we enjoy a wonderful record of long-term growth, we remain a small player in the global world of insurance. There is room for us to increase our market share for many years to come. We can use the tools of technology to increase our distribution reach and administrative expertise. We can add new people, new products, new companies and new offices for a long time. In 2010, we opened offices in Hong Kong, New York and Barcelona. There are still many places for us to put new pins, representing Markel offices, on a map of the world.

Fifth, we can thoughtfully manage the capital of the Company to create value. We measure our performance and progress on a per share basis at Markel. As opportunities present themselves to deploy capital for organic growth opportunities around the globe, acquire insurance or non-insurance businesses, or repurchase Markel common stock at attractive prices, we will do so.

Since the initial public offering of Markel Corporation in 1986, the insurance market has been what was described as "soft" in more years than not. Most of our associates have only seen one hard market in their entire insurance career! Despite this, we've managed to grow and create value. We expect to continue to be able to do so.

## A Digression on Accounting— Enjoy!

Our non-insurance holdings, Markel Ventures, continue to grow. Since launching Markel Ventures in 2005, we've grown from one business with revenues of approximately $50 million to six businesses with estimated revenues of over $250 million for 2011. The associated cash flows have followed as expected. We expect additional growth in these operations in coming years both organically and from acquisitions.

With the growth of Markel Ventures, it is important to add some new measures when reporting our financial results to you. We will begin to do so this year and in the years to follow by reporting EBITDA, or earnings before interest, taxes and depreciation and amortization, that Markel Ventures has produced for us. In 2010, Markel Ventures EBITDA was $20.4 million as compared to $4.6 million in 2009. For a reconciliation of Markel Ventures EBITDA to net income, see the table on page 130.

While we generally do not like EBITDA as a performance measure, it does provide useful information if you keep in mind several caveats. Here is the way we break it down by its components to make it useful to us. We share this with you so that you can see how we think about it ourselves.

First, we start with the "E," Earnings. These are the GAAP after-tax earnings of the businesses involved. They are the starting point for the EBITDA calculation and they are calculated in accordance with GAAP. If we had owned these businesses for a long time, rather than through recent acquisitions, we could just stop there.

It is fair to ask then, why are you adding back Interest, Taxes, Depreciation and Amortization? Aren't they real expenses? The honest answer is both yes and no, and we'll try to explain why in the paragraphs that follow.

Interest is clearly a real expense. As such, we count it in considering the economics of each of these businesses. Other than the real estate intensive business of ParkLand Ventures, we operate the Markel Ventures businesses with little or no debt. Consequently, the "I" factor of EBITDA is an insignificant difference between GAAP earnings and EBITDA. Whether we adjusted for "I" or not, the answer would be roughly the same under these circumstances.

Taxes are also real expenses. Real taxes though are affected by leverage and the associated deductible interest expense. In order to make effective apples to apples comparisons about the performance of underlying businesses which might have different amounts of debt in their capital structure, we add back the tax expense to make the results comparable.

Depreciation and Amortization get more interesting. Depreciation is the accounting method that tries to capture the sense of how much the capital equipment of a company is wearing out and what it will cost to replace it eventually. Fortunately, the Markel Ventures companies are not capital intensive and do not need massive doses of capital spending to remain competitive. This is an important aspect of what we are looking for when we purchase companies. Normally, we do not want to invest in businesses that require massive capital expenditures. As such, depreciation, like interest, tends to be only a minor factor in the adjustment from GAAP earnings to EBITDA.

Amortization represents the accounting effort to capture the cost of maintaining the intangible assets of a company each year. Given that the Markel Ventures companies have brand power in their markets and produce excellent cash flows, our purchase price reflects that reality and was a bigger number than just the hard asset values of existing working capital and real estate assets. The price we pay in excess of those tangible assets gets assigned to intangible assets and those intangible assets are written off over time in the amortization account.

We add back amortization to earnings as we are looking at the management teams and evaluating these businesses for two major reasons. First, as the CEO's of these businesses make decisions, amortization of intangible assets doesn't affect how they interact with their customers, manage their operations, price their products or any other fundamental aspect of running the business. Had we (or someone else) never purchased the business, this amortization would not exist. It is almost a "Lewis Carroll - Through The Looking Glass" type issue. If you look at these businesses from the point of view of Markel's financial statements, which is what we are doing in this report, the earnings of the companies are penalized by an annual amortization charge that starts on day one of the acquisition and goes away over a number of years.

If you are looking at the operations of these companies from the standpoint of the operating companies themselves, this charge does not exist. Most importantly, it does not affect the cash flow of the business no matter which way you are looking at it. Consequently, we add the amortization back to reported earnings to get a truer sense of the operating cash flow produced by the business.

Second, the other reason we add back amortization is that if the companies are well run, continuing to build the value of their brand and increasing their earnings, the intangible value of these companies should be INCREASING not DECREASING, as the presence of an amortization charge would suggest.

While we would not be so silly as to add an amortization income line to our financial statements, that is what should be occurring if we are doing our jobs well. Over time, as we increase the scale and scope of Markel Ventures and as our insurance operations differentiate themselves in the marketplace as unique and non-commodity solutions to customer problems, the value of Markel common stock should also trade at a growing premium to the stated book value to reflect this economic reality.

This is a new and growing issue for how Markel common stock should be fairly valued in the marketplace. We are no longer solely an insurance company that can be valued by the single dimension of price to book value. There are other factors involved. We have always recognized these additional features, and we are going through this accounting discussion to share our thoughts with you about some of the new components involved in evaluating and analyzing the performance of your Company.

To end this accounting digression, EBITDA, when suitably dissected and analyzed, provides a reasonable and appropriate method to judge the cash flow and value being produced by the Markel Ventures companies. As such, we will share this number with you. Also, you can be confident that we are not confused about the difference between GAAP earnings and EBITDA, and we pay a lower multiple of EBITDA than of GAAP earnings when making an acquisition.

## Acquisitions During the Year

During 2010, we completed the acquisition of FirstComp, a workers' compensation specialty operation serving roughly 8,000 retail agents across the United States. The company is skilled at designing and marketing workers' compensation coverage for small businesses and organizations and successfully uses advanced technology to meet clients' needs.

We are especially excited about the addition of FirstComp for several reasons.

First, we will offer additional Markel insurance products to FirstComp's current customer base. FirstComp's agency force already has thousands of customers that need additional types of insurance beyond workers' compensation, and we will offer the expanded array of Markel insurance products to them.

Second, FirstComp brings a marketing and technology focus that will be helpful throughout the Markel organization. Their disciplined and proactive sales process, along with the technological systems to market and administer their operations, will benefit the rest of Markel.

The beautiful thing about FirstComp is that through a focus on *small* accounts in *small* towns with *small* agencies serving *small* businesses, they've produced *big* results. We fully expect them to continue to do so in the future. However, 2011 will be a year of transition for FirstComp. Historically, FirstComp has operated a hybrid model of managing general agent and risk-bearing capabilities. As part of Markel, FirstComp will transition to primarily a risk-bearing operation. Also, as we have discussed countless times, Markel's reserving philosophy is to establish loss reserves that are more likely redundant than deficient. FirstComp's 2011 results will be impacted by the application of this long-standing philosophy to their business.

While we would love for FirstComp to be earnings positive from day one, we recognize the magnitude of the transition and the current sad state of the workers' compensation market. Given this backdrop, we would expect FirstComp to have an underwriting loss in the range of $30 million for 2011. This is not a surprise to us and does nothing to diminish our excitement. FirstComp has a bright future as part of Markel.

Markel Ventures also made several acquisitions during 2010. While each transaction remains small in isolation, the combined increases in revenues and cash flows are now meaningful to Markel.

Specifically, during 2010, we acquired Solbern and controlling stakes in RetailData Systems and Diamond Healthcare. Additionally, we made strategic, noncontrolling investments in Markel Eagle Partners and GoodHaven Asset Management.

Solbern manufactures equipment for the food processing industry and serves niche markets like pickle packing, hot fill beverages and convenience store fast food products. Solbern has operated in these markets for over 50 years. The installed base of its equipment and longstanding customer relationships are a testament to the solutions it can engineer for its customer base. Solbern will be included as part of our AMF operations.

RetailData provides real-time retail intelligence and data to grocery, general merchandise and drug stores and other retailers. RetailData started 20 years ago and has emerged as the leader in market intelligence services for the retail store industry. As part of Markel, the company now has a permanent capital base and the ability to increase its recent efforts to expand internationally as well as widen its customer base.

Diamond Healthcare provides behavioral health services in over 75 communities across the nation. Working in partnership with local hospitals and health care providers, Diamond brings specialized expertise in behavioral health issues to locations around the country. Diamond started 25 years ago in Richmond and has grown steadily over that time. Partnering with Markel creates a permanent capital structure for the company and will facilitate their ongoing expansion and long-term management stability.

We made strategic, noncontrolling investments in Markel Eagle Partners as well as GoodHaven Asset Management. Markel Eagle was formed to take advantage of opportunities in the Mid-Atlantic real estate markets. The principals of the firm have operated successfully for two generations and were well known to us. GoodHaven is a newly formed investment management company with mutual fund and separate account offerings. We've known the principals of GoodHaven for over a decade, and we are delighted to partner with them as they build a new firm.

In each of these instances, we follow the same four-part checklist that we use in investing in publicly traded securities. As long-time readers of this report will know, we are looking for profitable businesses with good returns on capital, run by honest and talented management teams, with reinvestment opportunities and capital discipline, at fair prices.

We have some critical advantages in our Markel Ventures operations compared to our holdings of publicly traded securities. Specifically, we retain control of the reinvestment and capital decisions as opposed to delegating that responsibility to an independent board of directors, and we can redeploy the cash flows from these companies anywhere within Markel in a highly tax efficient manner.

We operate these companies with little or no debt, and their ability to create unencumbered cash flow for Markel provides us with a strategic advantage. We expect to continue to add to our holdings of these profitable, well run businesses over time.

We also offer tremendous advantages to potential sellers of these businesses. We offer a long-term home for great businesses. If sellers want to make sure that their business is permanently placed in patient hands that will help current and future managers to build wonderful businesses, we are a unique buyer. We will not use excessive leverage or look to sell to subsequent buyers. That one sentence differentiates us from 90% of the other buyers in the world.

P.S. If you or someone you know owns a business that meets these criteria and would like to find a permanent home let us know.

## Information Technology

Last year, we described our Atlas initiative. It was our name to describe the transformation of our information technology systems to both modernize and update our systems as well as to change the fundamental architecture of our IT to reflect the One Markel business model.

2010 was a year of good progress in Atlas and the new systems are starting to be delivered and implemented. This will continue to be the case in 2011 and 2012.

Starting now though, the name Atlas will fade into history. As the One Markel model has taken shape, we have realized that our IT needs are to some extent different than we originally assumed. We have deemphasized and deferred some Atlas initiatives, such as the policy administration system, while increasing our focus in areas such as data warehouse and internet solutions for our agents, brokers and policyholders.

IT is crucial to our business each and every day. It is inappropriate to view Atlas as a one-time project with a start and end date. As we deliver specific projects over the next few years, our focus must and will shift to keeping our technology up to date and appropriate at all times.

As such, we will allocate appropriate capital to our IT efforts on a regular and continuous basis. With this steady source of support, we will prioritize and triage our efforts to continually adapt to what is new and needed and prune and discontinue that which is not new and no longer needed.

Technology efforts will be judged by the following standard:
Our technological approaches must be fast, flexible and cost effective. Every decision we make must be reviewed in those terms to assure that it fits that model. Whatever solutions exist today will be different in the future, and we need to be able to turn on a dime to adapt to new realities.

With appropriate ongoing resources and this standard, we are confident that we will deploy and maintain the right technology to run our business efficiently and effectively.

## Management Changes

In 2010, we formalized a management succession plan to perpetuate the long-term success of Markel. We formed an Office of the Chairman with Alan Kirshner as Chairman and Steve Markel and Tony Markel as Vice Chairmen. We also formed the Office of the President with Mike Crowley, Tom Gayner and Richie Whitt.

Alan, Steve and Tony created the vision for the modern Markel Corporation, which launched into the public arena in 1986. Their dreams for the Company took Markel from a small, regional insurance operation to a global insurance and financial firm. Through articulation of the values we all share as outlined in "The Markel Style," a series of bold acquisitions and day-to-day execution of the details, their leadership has presided over a great success story. They plan to continue their strategic and oversight roles indefinitely.

Mike, Tom and Richie assume day-to-day responsibility for the activities of the Company in this transition. Just as has been the case with Alan, Steve and Tony, each executive has ultimate responsibility and authority over certain functions of the Company. Clear boundaries, goodwill and the shared goals of only being interested in what is best for Markel have helped foster the necessary teamwork, as well as providing autonomy for the solo decisions needed from time to time.

This is an unusual structure but then again, Markel is an unusual company. We have had decades of success with this structure, and we are confident that it will continue into the future.

## Outlook

As we look towards 2011 and beyond, we are excited about the long-term prospects and future of Markel.

In our insurance operations, we continue to operate in a disciplined fashion and seek to produce underwriting profits.

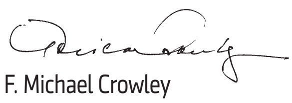
We will continue to expand geographically into new markets, we will make additional acquisitions as opportunities present themselves, we will train and grow our current talented associates and we will augment them with new, talented people. We expect ongoing growth in our non-insurance operations, and we will manage the capital as owners (which by the way, we are).

Markel Corporation enjoys an excellent record of creating value for its shareholders and associates over decades. We appreciate your support, and we are grateful for the opportunity to build such a great business. It takes time, patience, skill, dedication and some luck to get this done. We look forward to continuing to build on this legacy and reporting our progress to you.

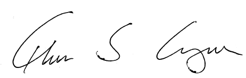
Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*Vice Chairman*

Steven A. Markel
*Vice Chairman*



F. Michael Crowley
*President and Co-Chief Operating Officer*



Thomas S. Gayner
*President and Chief Investment Officer*

Richard R. Whitt, III
*President and Co-Chief Operating Officer*

# 2011

## To Our Business Partners

Here is our 2011 annual report. Our goal in this report is, "to give you an overview of the corporation, our 2011 results and our plans and goals for the future." We put in the quotation marks because, other than updating the year to 2011, this was the exact phrase we used in the first annual report that Markel issued as a public company in 1986.

In 1986, it took us a grand total of 38 pages to cover the materials in the annual report with the letter taking the whopping total of one page. While our goals for communication remain exactly the same, immense regulatory changes in reporting practices and the wonderful growth of the business means that this year the report comes in at 138 pages. And the letter takes a bit longer too.

We apologize for the heft, but much has changed at Markel over the years, and we have a lot more to tell you in this report. We'll comment on 2011, as well as on longer term trends and developments at your company in the balance of this report. We also will try to give you some sense of why we are so optimistic about our future. We have a lot more ways to produce returns for you in 2012 compared to 1986. We believe we are on the cusp of a new and important era at Markel as a diverse financial holding company with global growth and profitability from our insurance, investment, and Markel Ventures industrial and service operations.

Make no mistake, 2011 was a challenging year. A series of record-setting catastrophes caused us to report an underwriting loss – the first since 2005, the year of Hurricane Katrina. As you know, our goal is to earn underwriting profits, and we have done so in seven of the last ten years. We remain committed to this goal and we are taking a series of actions in pricing initiatives, risk selection and efficiency measures to regain profitability in our insurance operations.

Financial markets also remained unsettled in 2011, still reverberating with aftershocks from the financial crisis of 2008. It was impossible to turn on a computer or see any news coverage that didn't include daily, throbbing reports of European debt and currency issues, unemployment problems, housing and mortgage market weaknesses or various and sundry other financial market problems.

| *(in millions, except per share data)* | **2011** | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|---|---|---|---|
| Total operating revenues | **$ 2,630** | 2,225 | 2,069 | 1,977 | 2,551 | 2,576 | 2,200 | 2,262 | 2,092 |
| Gross written premiums | **$ 2,291** | 1,982 | 1,906 | 2,213 | 2,359 | 2,536 | 2,401 | 2,518 | 2,572 |
| Combined ratio | **102%** | 97% | 95% | 99% | 88% | 87% | 101% | 96% | 99% |
| Investment portfolio | **$ 8,728** | 8,224 | 7,849 | 6,893 | 7,775 | 7,524 | 6,588 | 6,317 | 5,350 |
| Portfolio per share | **$907.20** | 846.24 | 799.34 | 702.34 | 780.84 | 752.80 | 672.34 | 641.49 | 543.31 |
| Net income (loss) to shareholders | **$ 142** | 267 | 202 | (59) | 406 | 393 | 148 | 165 | 123 |
| Shareholders' equity | **$ 3,388** | 3,172 | 2,774 | 2,181 | 2,641 | 2,296 | 1,705 | 1,657 | 1,382 |
| Book value per share | **$352.10** | 326.36 | 282.55 | 222.20 | 265.26 | 229.78 | 174.04 | 168.22 | 140.38 |
| 5-Year CAGR in book value per share[1] | **9%** | 13% | 11% | 10% | 18% | 16% | 11% | 20% | 13% |

[1] CAGR—compound annual growth rate

Finally, we still have, and always will have, improvements we want to make to our business systems and processes. In 2012, the combination of increased revenues and greater efficiency should help reduce our expense ratio, but we know that there is more hard work to be done to get that measure in line with our goals.

Despite all of those factors, your company reported record revenues of $2.6 billion, an increase of 18% from the $2.2 billion in 2010, and a new record high book value per share of $352.10, up 8% compared to $326.36 a year ago. While these represent small advances and lower rates of increase than we would like, we are nonetheless pleased to be able to report these advances to you in a year with as many challenges as 2011.

We dream of the days when insurance market conditions are more favorable than they have been during the last several years. We even see tangible signs of that happening. We also look forward to steadier and sounder general economic and financial market conditions. We are optimistic that the financial markets are in fact healing.

We think that better external conditions are on the horizon, and we pledge our efforts to improve our daily execution of the business so that we can make the most of them.

Our record over time should give you some comfort in our prospects for the future. As always, we include a 20-year table with key financial highlights to demonstrate the long-term financial performance of your company and document the progress of Markel over a meaningful period of time.

One key reason why things have worked out so well for Markel over time is the environment of TRUST that exists at your company. We appreciate that you as shareholders have entrusted us with your capital to build the value of your investment over time. You've given us great latitude to pursue this goal without artificial constraints, and we've validated your faith in us by producing excellent results over time.

We work hard every day to maintain and build a level of trust around Markel because we think that makes our business better. It is almost magical to live in this environment and enjoy the mutual commitment that the people of this company feel towards each other and towards the company.

In this environment, we are all dedicated to building a legacy that goes beyond the simple matter of a job. In an environment of trust, individual skills are magnified and the business becomes something more than just the sum of its parts. That intangible essence is the secret behind the decades of success at Markel and what we are working diligently to increase over time throughout our growing array of insurance and Markel Ventures operations.

In some ways, trust is the key factor in the overall economic environment as well. Prior to the 2008 financial crisis, most people were willing to enter into transactions and engage with one another in an environment of trust. People trusted the veracity of what was on the mortgage application. People trusted that

| 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 | 20-Year CAGR[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1,770 | 1,397 | 1,094 | 524 | 426 | 419 | 367 | 344 | 280 | 235 | 206 | 223 | 13% |
| 2,218 | 1,774 | 1,132 | 595 | 437 | 423 | 414 | 402 | 349 | 313 | 304 | 406 | 9% |
| 103% | 124% | 114% | 101% | 98% | 99% | 100% | 99% | 97% | 97% | 97% | 106% | — |
| 4,314 | 3,591 | 3,136 | 1,625 | 1,483 | 1,410 | 1,142 | 927 | 622 | 609 | 457 | 436 | 16% |
| 438.79 | 365.70 | 427.79 | 290.69 | 268.49 | 257.51 | 209.20 | 170.95 | 115.45 | 112.55 | 84.64 | 81.77 | 13% |
| 75 | (126) | (28) | 41 | 57 | 50 | 47 | 34 | 19 | 24 | 26 | 14 | 12% |
| 1,159 | 1,085 | 752 | 383 | 425 | 357 | 268 | 213 | 139 | 151 | 109 | 83 | 20% |
| 117.89 | 110.50 | 102.63 | 68.59 | 77.02 | 65.18 | 49.16 | 39.37 | 25.71 | 27.83 | 20.24 | 15.59 | 17% |
| 13% | 18% | 21% | 22% | 23% | 26% | 26% | 31% | 17% | 25% | 34% | 35% | — |

their houses would go up in value over time. People trusted that insurance companies would be there in the future to pay claims. People trusted that deposits in the bank were money good and so on and so on and so on.

In fact, people trusted too much without checking to see if it was really true. And in many cases the trust was violated.

Now, the opposite environment exists. People don't trust enough. Banks in general are not enthusiastic and trusting when it comes time to lend money. They want additional verification and documentation that might be erring on the side of not trusting enough. Investors and consumers in general seem to look at business propositions with a jaundiced eye. As such, they are entering into fewer transactions than they previously did in a different era and when they do transactions they are taking longer to get done.

All of this causes a slower, more ponderous and less vibrant economic environment.

We spent years in an environment of systemic goodwill and trust. Now we are wandering through a desert period of skepticism and distrust. We do not offer any guesses as to how long it will take to get through this era in the general environment, but we are optimistic that this too shall pass.

What we can do now though, and what we can control, is the environment within the walls of Markel Corporation. Thanks to decades of practice, leadership and continuous reinforcement, this is a company that demands trustworthiness from its people. As such, the amount of time we all spend working cooperatively and positively swamps the time we spend doubting or distrusting our colleagues. Consequently, we get a lot more done around here than would be the case if this were not an environment of trust.

That is an amazing culture and the true underlying reason for the long-term success of Markel Corporation and the key to our future.

We are confident that our culture continues to grow and develop in more corners of the world and in more and different businesses. While we enjoy an enviable track record of long-term growth and financial success, we remain a tiny company on the world stage. We've got a lot of room to grow.

We have immense amounts of runway to expand our insurance and Markel Ventures operations everywhere in the world. We are just getting started, and we're glad you're along for the ride. Buckle up.

Now, we get back to the three-part task of providing you with an overview of the corporation, a review of our 2011 results and our plans and goals for the future.

## First — An Overview of the Corporation

Markel continues to strategically adapt and grow at rapid rates.

Two decades ago, we were a small, newly public, U.S. specialty insurance company.

One decade ago, we were a small, newly international insurance company.

Today, we are a diverse financial holding company with global insurance, investment and Markel Ventures operations all around the world.

As we stand today, Markel operates insurance companies in the International, Specialty and Excess and Surplus markets. We also own a diversified set of industrial and service businesses through Markel Ventures.

Throughout the years of building this array, we've earned good returns on the capital you have entrusted to us. We've successfully increased the scope and scale of the company over time, and we are excited about our prospects as we continue to do so.

## International

In 2011, our International insurance operations wrote total gross premium volume of $825 million versus $709 million in 2010. The combined ratio was 116% versus 95% a year ago as this unit felt the biggest brunt of the record catastrophe year. The list of 2011's weather and catastrophe events sounds almost biblical with floods in Australia and Thailand, earthquakes in New Zealand, earthquakes and a related tsunami in Japan, and tornados and hurricanes in the United States.

Fortunately, the losses from each of these events were within our risk tolerances. What we didn't anticipate was the large number of significant catastrophic events.

Property and catastrophe insurance rates are moving up in response to these industry-wide losses. We will write catastrophe business when we think we are being adequately paid for the risks incurred, and we will also continue to be selective about what catastrophe-related risks we will write at all.

While our underwriting techniques and strategy are clearly better today than in 2005, the total number of events this year exposed the high stakes involved in insuring catastrophes. We will refine and review our exposures in view of this year's result and seek to improve the profitability of writing catastrophe business. If the market is not willing to pay an appropriate price, we are prepared to walk away from many catastrophe-exposed risks.

We continued to expand our international scope of operations with the opening of a new branch in Rotterdam, Holland. We also increased our presence in Sweden with two small acquisitions, opened our second office in Spain in Barcelona and opened small offices in Hong Kong and Beijing.

We are beginning to see rate increases on more and more of our international book of business, and we continue to enjoy immense expansion opportunities as we build the skill of operating a global business.

## Specialty

Specialty gross written premium volume was $572 million in 2011 compared to $375 million in 2010 with a combined ratio of 109% versus 100% last year. Included in the 2011 Specialty numbers is gross premium of $227 million related to FirstComp.

We enjoyed our first full year of ownership of FirstComp and are pleased with its integration into Markel. As we have stated previously, 2011 was a transition year for FirstComp. During the year, we completed the conversion of its managing general agent operation to a risk bearing operation. We also transitioned the pricing and reserving approaches to be consistent with Markel's level of conservatism. The results for FirstComp came in within our expectations and as it regards premium writings, slightly ahead.

Additionally, we have laid the groundwork in 2011 to cross sell products in the future. We expect to offer FirstComp workers' compensation products through the Markel distribution channel and to distribute Markel's specialty products through FirstComp's producers.

Another benefit we have enjoyed from this acquisition is new leadership talent. There is depth and breadth of talent at FirstComp that ensures its success and which can be leveraged across the Specialty division.

All of these elements demonstrate that this is truly a win-win situation and how a good acquisition should work.

We also added several new programs in our Specialty division such as a wine program, Boys and Girls Clubs, garden centers and nurseries programs, renters' insurance and others.

In January 2012, we completed the acquisition of Thomco. Thomco is a program administrator with 30 years of operating history headquartered in Atlanta, Georgia. Thomco is led by Greg Thompson and Bob Heaphey who have joined the Markel team and will lead our Specialty program business.

Thomco has approximately 20 insurance program offerings such as medical transportation, senior living, childcare, fitness clubs, pest control and inflatable rental operators, among others. They have a distribution network of approximately 4,500 independent agents across 50 states.

Thomco represents an important addition to our product offerings and a major expansion of our Specialty book. This transaction closed during the first week of 2012 and should contribute in an increasing fashion throughout the year as programs are transferred to Markel's insurance companies.

## Excess and Surplus

For the year, Excess and Surplus gross written premiums totaled $893 million versus $898 million a year ago. The combined ratio was 86% in 2011 versus 96% in 2010.

2011 continued to validate the One Markel business transformation program. We can see the effectiveness of the approach through increases in submission activity from our wholesale insurance distribution partners. Our producers are becoming more familiar and comfortable with the model and are finding it easier to access our menu of products.

Our goal when we started down the path of One Markel was to be "easier to do business with." We are pleased to report that the facts seem to indicate we are making progress in this goal.

The Excess and Surplus market tends to be the tail end of the whip of the insurance marketplace and rises and falls most dramatically in volumes and profitability during the course of a cycle. When the market is extremely competitive, the Excess and Surplus market suffers the most. The opposite is true when competition is decreasing and prices are improving. While 2011 remained a period of generally soft insurance pricing, we are encouraged by the trends we began to experience as the year progressed. Pricing appears to be improving and competition appears to be cooling in some lines. If these trends continue, they could greatly benefit our Excess and Surplus operations.

According to various industry-wide statistics, the insurance industry experienced the highest level of catastrophe losses ever of $105 billion. Given these losses and the ongoing low levels of interest rates, the insurance industry is unable to make an economic profit. This situation cannot persist. Sooner or later, the industry runs out of money to run out of. Sadly, the industry always seems to try to see how close they can get to that outcome before they come to their senses and change their operational and pricing behaviors.

We continue to get closer and closer to the day when insurance prices rise industry-wide and provide a more favorable operating backdrop for Markel. We will enjoy that time but make no mistake, we are not waiting until then to take actions which improve profitability now.

## Markel Ventures

During 2011, other revenues, which primarily represent the Markel Ventures companies, rose 89% to $351 million versus $186 million in 2010. Earnings before interest, taxes, depreciation and amortization from the Markel Ventures operations rose 83% to $37.3 million from $20.4 million. For a reconciliation of Markel Ventures EBITDA to net income to shareholders, see the table on page 132.

During the year, we announced the acquisition of PartnerMD and of a controlling interest in Weldship. AMF and Ellicott, existing Markel Ventures subsidiaries, also made acquistions that added to the scope of their businesses.

PartnerMD is a concierge medical practice headquartered in Richmond, Virginia. We believe that PartnerMD has developed one of the answers to the problems facing our troubled medical system. While the business is small today, we expect many years of meaningful growth.

Weldship provides tube trailers and storage equipment for the industrial gas industry. Weldship is a leader in its industry and has operated since 1946. The company provides sales and leasing solutions to a variety of industrial companies. The company enjoys a long record of consistent, profitable growth and good returns on capital. We look forward to that continuing as part of Markel.

Both of these firms should benefit from the larger and permanent capital base of Markel Corporation. Their customers can be confident that these firms will continue to be permanent and reliable providers of the products and services they need. Current and future employees know that they can focus on serving their customers and building a business rather than worrying about the fate of their company.

Our belief, and what we have observed so far in Markel Ventures, is that our permanent capital base and long-term business focus create the best economic outcome over time.

We continue to look for additional acquisitions, and we expect more long-term growth from the Markel Ventures operations. As we have stated before, if you or someone you know owns a profitable business, with talented and honest management, capital discipline, and wishes to find a great long-term home for that business at a fair price, call us. We appreciate the first hand contact from principals looking to join Markel Corporation.

## Investments

Our total investment return in 2011 was 6.5%. In our fixed income operations, we earned 7.6% and in our equity portfolio, we earned 3.8%.

Interest rates started the year low and went lower. As such, our total return exceeded the coupon, or natural return, that we would expect from the portfolio of bonds that we own. This is a two-way street and what we gained in excess return in 2011 we are likely to give back in 2012 or beyond. This is a matter of when, not if.

We believe that the natural level of interest rates is something other than zero. As such, we continue to own shorter term bonds than we would normally choose. This costs us current investment income but it protects our balance sheet and total return against a rise in interest rates. We've been concerned about this risk for a few years now and being early can be easily confused with being wrong about our view on the direction of interest rates.

We can't shake our concerns about the risks to bonds and interest rates from current government policies, and we will continue to exercise caution about accepting this risk on your behalf. We just don't think we're getting paid adequately to take this risk and, as such, we will act just like we do in our insurance business and effectively walk away from what we believe is an unwise deal for Markel shareholders.

In our equity portfolio, we continued to follow our historical and unchanging four-point discipline of seeking profitable businesses with good returns on capital, led by honest and talented managers, with reinvestment opportunities and capital discipline, at fair prices.

This four-point phrase should be familiar to long-term readers of this annual report because it has and will remain unchanged. These attributes are attractive at all times and guide our selection of publicly traded and privately held businesses.

We are pleased with the long-term returns we have earned following this approach and while our returns were modest in an absolute sense in 2011, they continued to be outstanding on a relative basis to appropriate bogeys. We continued to modestly and steadily add to our equity holdings throughout the year, and we expect more of the same in 2012.

We believe our equity portfolio is earning double-digit returns on an underlying basis and shows all signs of continuing to do so. Over time, if our analysis is correct, those returns will be reflected in market prices just as they have in the past.

Additionally, our equity investment commitment is increasingly at odds with general marketplace behaviors. In aggregate, individuals and institutions have steadily moved away from equity investments during this decade-plus period of unattractive returns.

Various labels such as alternative investments, hedge funds, private equity, commodities, bonds, FX trading, arbitrage and other categories of investment products continue to receive allocations from the investment community at the expense of ownership interests in businesses, i.e. stocks.

While equity returns may seem low today, we prefer the prospects of double-digit returns that we expect compared to the mathematical certainty of low single-digit returns available from high quality fixed income alternatives.

We also prefer these prospective returns given the low cost structure and tax efficiency we gain by managing our investments ourselves rather than farming that function out to others.

To demonstrate, say we invested $100 with an alternative asset manager who produced a spectacular 20% return, or $20 on our investment. Typically, we would be charged an asset management fee of 2% and a profit participation charge of 20%. The management fee would reduce our $20 to $18 right off the bat. The profit participation fee would further reduce that $18 to $14.40. Typically, these sorts of returns involve high amounts of trading, so assume that the $14.40 is taxed fully at a corporate tax rate of 35%. That reduces our after-tax net return to only $9.36.

By contrast, our internal costs to manage our investments are less than 10 basis points. If we were to produce the same returns internally, our gross return of 20% would become $19.90 after management costs. There are no profit participation expenses. Also, our portfolio turnover averages less than 10% per year. As such, only $2 would be a realized gain and subject to the 35% tax rate. The cash tax bill would be $.70 and that means we would still have $19.20 to add to our investment portfolio at the end of the year, compared with only $9.36 from the same gross return produced by an alternative asset management structure.

We prefer the alternative of keeping this work in house and giving ourselves a better chance of producing net returns for our shareholders. As John Bogle once said, “Returns are uncertain, costs are certain.” Our structure aims to reduce the certain costs and get the most we can out of the uncertain returns.

Fortunately, we can point to a record that shows we have earned solid returns over long periods of time in our equity investment activities. We stuck to our discipline despite periods of headwinds. We continue to expect our time-tested, low cost and tax efficient approach to produce good results for you as our shareholders. This should be a point of differentiation for Markel over the next several years.

## Second — Our 2011 Results

Our total operating revenues grew 18% to $2.6 billion in 2011 from $2.2 billion in 2010. Earned premiums were $2.0 billion compared to $1.7 billion a year ago, and the combined ratio for the year was 102% compared to 97% in 2010. Investment income totaled $264 million compared to $273 million in 2010, and other revenues were $351 million compared to $186 million a year ago.

On our balance sheet, total shareholders' equity rose to $3.4 billion up from $3.2 billion, and book value per share rose to $352.10 compared to $326.36 a year ago. Debt to total capital increased to 27% from 24% a year ago due to the $250 million issuance of 5.35% ten-year senior debt.

We remain balance sheet oriented at Markel. We strive to make our loss reserves more likely redundant than deficient, and we err on the side of conservatism in maintaining the integrity of the balance sheet. This is a core value of Markel that will not change.

In our insurance operations, we produced a combined ratio of 102% versus 97% a year ago. This year's results were negatively affected by floods in Australia and Thailand, earthquakes in New Zealand, earthquakes and a related tsunami in Japan, and tornados and hurricanes in the United States. The total impact from all of these events was eight points on the combined ratio in 2011.

Our goal is to earn underwriting profits, and we are disappointed that we failed to meet that goal this year. While the sheer number of events was well beyond what we anticipated, the catastrophe losses we experienced did not exceed our expectations on any single event.

In our investment operations, we enjoyed a productive year. Total investment return was 6.5% in 2011 with equities up 3.8% and fixed income up 7.6%. We remain optimistic about future returns from our equity investment operations. We continue to have more ideas than money and that is a good recipe for future returns.

2011 exposed ongoing flaws in the world of finance. European area issues dominated the headlines, but we are cautious and conservative about credit quality everywhere. Specifically, our Eurozone holdings represent approximately 8% of the total portfolio and are the highest credit quality instruments we can find.

We continue to match the currency exposures from our underwriting operations with a portfolio of high quality fixed income investments and this drives our investment exposures in the Eurozone. As an example of our caution, our exposure to headline countries such as Portugal and Ireland is less than 1% of the total portfolio and we have no direct exposure to Greece.

In addition to our caution about credit quality, we continue to be concerned about the likelihood of higher interest rates. We think this is a matter of when, not if.

In preparation for higher interest rates, we've continued to keep the maturity of our bond portfolio short. As bonds have come due, we've replaced them with bonds that have shorter maturities. This pinches current investment income, but we think that protecting the balance sheet from big price declines that would occur on long term bonds if interest rates rise is the right decision.

## Third — Our Plans and Goals for the Future

We are stewards of a big dream at Markel. We think that we can build one of the great companies of the world. It will be marked by unquestioned financial success and stand as an exemplar of how business should be done.

We will serve our customers to the best of our ability. We will earn a fair profit for doing so, as our customers pay us appropriately for providing necessary services. We will operate with integrity and in a first class manner in all respects. We will respect our shareholders and treat them fairly. And we will be a company where talented and honest individuals want to work.

2011 was a year of modest financial progress but tremendous overall progress towards this goal. We continued to make improvements in our historical wholesale insurance business. We expanded the offerings and capabilities of our Specialty insurance operations with the first full year of the FirstComp operations as part of Markel, a series of new product introductions and the announcement of the Thomco acquisition at year end. Our international division opened new offices in Holland, Sweden, Spain, Hong Kong and Beijing and expanded operations in existing markets. Markel Ventures acquired PartnerMD and Weldship, as well as businesses that expanded the scope of its existing AMF and Ellicott subsidiaries.

We recognize that the financial results were less than what you, or we, expect and we acted accordingly. As such, the signers of this letter received no bonuses or salary increases for 2011 with only one exception. That exception relates to an employent agreement struck in 2009 in conjunction with joining Markel and walking away from earned compensation at a previous employer.

We think this demonstrates appropriate leadership and commitment to the shareholders and the organization, and that it stands in sharp contrast to numerous examples of less than wonderful corporate behavior.

We are working harder than ever, and we hope (as you should) that compensation and bonuses will increase soon to reflect the increased returns we hope to produce for you. Meanwhile, we will demonstrate our commitment to integrity and leadership by setting what we believe is a good example for the business and placing your interests first.

In addition to the daily execution and operation of the business, we think we have four main tools to grow and build the value of Markel. One, we can reinvest in organic opportunities in our insurance operations; two, we can acquire additional insurance businesses; three, we can acquire partial or controlling interests in public or private operations through Markel Ventures; and four, we can repurchase our own stock when we have excess capital and it is favorably priced.

*From left to right: Steven A. Markel, Thomas S. Gayner, Richard R. Whitt, III, F. Michael Crowley, Anthony F. Markel and Alan I. Kirshner.*

Most companies do not actively utilize this array of options. At Markel, during 2011, we engaged in all four activities. We fully expect to continue to analyze and review these alternatives and to use any and all of them as appropriate to build value.

As we begin 2012, we are incredibly optimistic and grateful to be part of this company.

The people of Markel have created a wonderful long-term record of financial success. The people of this company will be the ones to build that record in the future. We are confident and excited to field our team with a mix of proven veterans and new associates that are dedicated to serving customers and making everything that they touch better.

It is a timeless recipe for success, and we appreciate your long-term support and commitment as shareholders as we continue to build the human and financial value of your company.

Thank you.

Alan I. Kirshner
*Chairman of the Board and Chief Executive Officer*

Anthony F. Markel
*Vice Chairman*

Steven A. Markel
*Vice Chairman*

F. Michael Crowley
*President and Co-Chief Operating Officer*

Thomas S. Gayner
*President and Chief Investment Officer*

Richard R. Whitt, III
*President and Co-Chief Operating Officer*

# 2012

## To Our Business Partners

Each year we write this letter to you to discuss the results of the past year and our plans and aspirations for the future. We think of you as business partners who have trusted us with your firm. Through this letter, we try our best to tell you how we think about your company, what happened over the course of the last year, and what you should expect of us in the year(s) to come. We also write this letter to our colleagues throughout Markel to provide a sense of perspective on how things have gone for the organization as a whole, and to provide a sense of where we are going.

Well, partners, this has been one heck of a year. 2012 was busy. More things went on this year than any in recent memory. There is a long list of things we accomplished. We've also got a full slate of ongoing goals in place, and actions taken to build the future of your company.

Financially, we enjoyed record revenues of $3.0 billion, an increase of 14% from $2.6 billion in 2011. Book value per share increased 15% to $403.85 versus $352.10 a year ago, and comprehensive income totaled $509 million versus $258 million. We also returned to underwriting profitability, with a combined ratio of 97% compared to 102% in 2011.

Given the events of 2012, this letter sets a new record for length. If you have attention deficit disorder and just want to know the highlights, you can read through the bullet points listed below and leave it at that. If you want more details, keep reading. We'll describe each of them in more substance through the rest of the letter.

### The 2012 Headlines

1. We produced an underwriting profit despite Hurricane Sandy
2. We earned excellent returns on our investment portfolio
3. We acquired Thompson Insurance Enterprises
4. We announced the formation of our partnership with Hagerty and the associated acquisition of Essentia Insurance Company
5. We continued the successful integration of FirstComp
6. We successfully implemented our data warehouse
7. We enjoyed organic growth in insurance premiums
8. We continued to report favorable loss reserve development
9. We acquired Havco, Reading, Tromp, and Idreco within our Markel Ventures organization
10. We improved our operational performance in our insurance units as well as in our claims and shared services operations

| *(in millions, except per share data)* | **2012** | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|---|---|---|---|
| Total operating revenues | **$ 3,000** | 2,630 | 2,225 | 2,069 | 1,977 | 2,551 | 2,576 | 2,200 | 2,262 |
| Gross written premiums | **$ 2,514** | 2,291 | 1,982 | 1,906 | 2,213 | 2,359 | 2,536 | 2,401 | 2,518 |
| Combined ratio | **97%** | 102% | 97% | 95% | 99% | 88% | 87% | 101% | 96% |
| Investment portfolio | **$ 9,333** | 8,728 | 8,224 | 7,849 | 6,893 | 7,775 | 7,524 | 6,588 | 6,317 |
| Portfolio per share | **$969.23** | 907.20 | 846.24 | 799.34 | 702.34 | 780.84 | 752.80 | 672.34 | 641.49 |
| Net income (loss) to shareholders | **$ 253** | 142 | 267 | 202 | (59) | 406 | 393 | 148 | 165 |
| Shareholders' equity | **$ 3,889** | 3,388 | 3,172 | 2,774 | 2,181 | 2,641 | 2,296 | 1,705 | 1,657 |
| Book value per share | **$403.85** | 352.10 | 326.36 | 282.55 | 222.20 | 265.26 | 229.78 | 174.04 | 168.22 |
| 5-Year CAGR in book value per share[1] | **9%** | 9% | 13% | 11% | 10% | 18% | 16% | 11% | 20% |

[1] CAGR—compound annual growth rate

…and…as the year was winding down…, we announced the acquisition of Alterra. This is a major transaction which adds substantial heft and market presence to Markel Corporation and is accretive to the book value, premium, and investment balances behind each share.

This is a *full* list. The people of this organization ran at a full sprint throughout 2012 to accomplish these items, and they are all hard at work to assure progress on these and other initiatives for 2013. The signers of this letter would like to personally thank all of those involved in the events of 2012. None of them were easy, and all of them will act in concert to make Markel Corporation a stronger, more vibrant, and more profitable company in the years to come. We thank all of you for your efforts.

Now, here are some details behind each of the bullet points.

### 1. We produced an underwriting profit despite Hurricane Sandy

We've produced outstanding results for our shareholders over time and the core, fundamental, building block in doing so begins with earning an underwriting profit. 2012 was a year in which we started with this building block in place, as we achieved a profitable combined ratio of 97%, which includes five points of underwriting loss from Hurricane Sandy, compared to the unprofitable 102% in 2011.

It is *always* the goal at Markel to produce an underwriting profit. We did so in 2012, and we've done so in eight out of the last 10 years, and 14 of the last 20. Producing an underwriting profit is one of those things that is easy to say and hard to do. It requires an immense effort with many moving parts to accomplish this, and we're proud of this record. The years without underwriting profits occurred during major headline catastrophes such as the World Trade Center attack, Hurricane Katrina and sometimes, as anticipated, in the wake of major acquisitions which required changing the underwriting culture at acquired firms.

The good news is that each of those events, while painful, taught us something, and we learned to be better at managing risks and running your company. Each of these "learnings" caused us to reexamine our processes and assumptions and to improve them going forward. Each challenge caused us as individuals, and as teams, to figure out how to improve and find new ways to succeed.

The fact that we earned an underwriting profit this year despite Hurricane Sandy speaks to how we've learned and improved our underwriting process. The losses from Sandy were within our risk tolerances. We served our policyholders by providing insurance coverage, and we earned a profit while doing so. That is a "win-win" situation for all involved.

The cumulative effect of this learning process continues to produce wonderful results for Markel shareholders. Over the last 10 years, book value per share increased at a rate of 13%, and for the last 20 years that rate has been 16%. By contrast, the S&P 500 rose 7% and 8% respectively over those time periods.

Recently, a head coach made a seemingly counterintuitive statement before a game when he said, "I think that the team that makes the most mistakes will win." That sounded like an unusual statement, but he went on to say that his team needed to be aggressive, and be willing to make mistakes, to produce a victory. An unhealthy fear of mistakes can lead to being too passive or fearful. That leads to stiffness and subpar

| 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 20-Year CAGR[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2,092 | 1,770 | 1,397 | 1,094 | 524 | 426 | 419 | 367 | 344 | 280 | 235 | 206 | 14% |
| 2,572 | 2,218 | 1,774 | 1,132 | 595 | 437 | 423 | 414 | 402 | 349 | 313 | 304 | 11% |
| 99% | 103% | 124% | 114% | 101% | 98% | 99% | 100% | 99% | 97% | 97% | 97% | — |
| 5,350 | 4,314 | 3,591 | 3,136 | 1,625 | 1,483 | 1,410 | 1,142 | 927 | 622 | 609 | 457 | 16% |
| 543.31 | 438.79 | 365.70 | 427.79 | 290.69 | 268.49 | 257.51 | 209.20 | 170.95 | 115.45 | 112.55 | 84.64 | 13% |
| 123 | 75 | (126) | (28) | 41 | 57 | 50 | 47 | 34 | 19 | 24 | 26 | 12% |
| 1,382 | 1,159 | 1,085 | 752 | 383 | 425 | 357 | 268 | 213 | 139 | 151 | 109 | 20% |
| 140.38 | 117.89 | 110.50 | 102.63 | 68.59 | 77.02 | 65.18 | 49.16 | 39.37 | 25.71 | 27.83 | 20.24 | 16% |
| 13% | 13% | 18% | 21% | 22% | 23% | 26% | 26% | 31% | 17% | 25% | 34% | — |

results. It is important to be willing to act positively, and accept reasonable mistakes, so that the organization can learn, and grow, and deal with a rapidly changing world.

We do that at Markel, and we think that this willingness to take personal responsibility, admit errors, learn, and move forward is a unique competitive advantage for the company.

*The first key to our consistency in earning underwriting profits is our discipline and our unwavering commitment to this standard.* We are all long-term partners in Markel, and we don't willingly accept any underwriting proposition which we think carries the likelihood of an underwriting loss. While we may not get this right all of the time, we start out with the advantage of a clear sense of purpose. No underwriter in Markel receives incentive compensation unless his or her book of business produces an underwriting profit. Furthermore, that is not just a one year assessment, but a multi-year view. Long-term risks require long-term measurement, and we reward our talented underwriters only when we have reasonable certainty that their books of business are indeed profitable over time. We are confident that our new Alterra colleagues, as well as the existing Markel underwriting team, will enjoy professional and personal achievement by being part of a long-term winning organization. We find that the best underwriters welcome and enjoy this approach since it yields the best professional outcomes possible for them. Underwriters at Markel are not asked to subsidize weaker performers. A great underwriter will do better at Markel than at other organizations that do not have such a firm commitment to underwriting profitability.

We welcome our new colleagues from Alterra, and we are confident that they will find that the long-term focus, and rational nature, of Markel will be the best possible environment for them to realize their professional potential.

## 2. We earned excellent returns on our investment portfolio

During 2012, we earned a total return of 9% on our investment portfolio. Our equity returns were 20% and our fixed income returns were 5%. We are very happy with these results, and we hope that you are as well.

The 2012 equity returns of 20% added to a long string of excellent results. Over the last 10 years, we've earned a total equity return of 9% versus the S&P 500 index returns of 7% and for the last 20 years we earned 10% versus the index return of 8%.

Over the years, we've never made decisions based on our forecasts of what was ahead for the economy, governmental policies, tax rates, currency values, interest rates, technological changes or other incredibly important but fundamentally unknowable future developments.

Instead, we've simply looked at individual companies, one at a time, and asked ourselves a few questions. By considering four basic types of questions about individual companies and securities we try to develop enough confidence to make a decision.

Our first question is, "Is this a profitable business with good returns on capital without using too much debt?" Second, we ask ourselves, "Is the management team equally and sufficiently talented and honest?" Third, we ask, "What are the reinvestment dynamics of the business and how do they manage capital?" and finally we ask, "What is the valuation and what do we have to pay to acquire ownership in the business?"

While these are four simple questions, the process of thinking deeply about them tends to produce robust results over time as demonstrated by our long-term record. Those questions also tend to encompass consideration of some of the macroeconomic factors that tend to cause so much worry and anxiety for so many investors.

Consider the first question of profitability and returns on capital. The best and most durable businesses in the world are ones that serve their customers well. Profitability is a marker that says a business is serving its customers with products that they need and want and that they are efficient and skilled enough in doing so that there is a measure of profit left over after all is said and done.

If a business is not making an appropriate profit it means that either they are doing something that the customers don't particularly care about, or that they are not good enough at the task to accomplish it in a cost effective manner. Neither one of those outcomes is good. As such, just thinking about the long-term profitability and return on capital record of a business gives us a wonderful insight into whether the company is indeed serving its customers in a fruitful way.

The best marker to describe a successful long-term company is a long-term record of profitability and good returns on capital, and that is the first thing we look for in seeking equity investments in either our public or private equity investments.

Second, we think about the talent and integrity of the managers running the business. If a manager has integrity but is short of talent, that manager may be a very nice person and a pleasant friend or neighbor. However, in the context of business, they can't get the job done and that will not produce a good economic outcome. Similarly, if someone is talented but has an integrity problem, they might do something profitable in the short run but it will fall apart in the fullness of time.

We look for these same attributes in all of our colleagues inside Markel, in the managers of the companies in our public security portfolios, and the managers of the companies we've acquired in our Markel Ventures operations.

Third, we think about the reinvestment dynamics of a business. A wonderful business can take the profits it earns and reinvest them at similar or better returns over time and compound value. Organic growth companies like this are rare and hard to find and none of them last forever. In this world, perfection is not attainable, but we try to snuggle up as close to it as we can whenever we can find it.

The second best business in the world is one that makes very good returns on capital but cannot fully reinvest the profits at similar rates. Those businesses are fine as long as the management team accepts the reality and allocates capital to other uses. In our public equity holdings we own several fine businesses which meet this definition and pay meaningful dividends, repurchase shares, or make good acquisitions. Also, within our Markel Ventures operations, several of our companies match this profile.

When we own a controlling interest in a company like this we can make the capital allocation decisions and do so in a very tax-efficient manner. While we pay full taxes at any entity when they make money, we can subsequently re-allocate the earnings from any area of Markel to any other, all around the world. By contrast, when we earn passive income through the receipt of dividends on our public equity portfolio, the paying companies paid taxes on their earnings and we pay a tax on the dividends received. By building the controlled interests of Markel Ventures operations, we are able to eliminate this tax drag and increase the value of Markel with less friction than would otherwise be the case.

Fourth, we think about the valuation we must pay to buy a company with the three lovely attributes we described earlier. We've learned over the years, as Charlie Munger from Berkshire Hathaway noted, that, "it is better to pay a fair price for a great business than a great price for a fair business." Great businesses compound their value over time while fair businesses wallow in mediocrity. As long as we find great businesses at reasonable prices, we'll allocate your capital to owning them to the fullest extent possible. When great businesses sell for irrationally high prices, and sometimes they do, we'll build cash, continue to look elsewhere, and continue our search for long-term compounding machines that are otherwise known as common stocks of great businesses.

Finally, we are pursuing unusual tactics in our investment strategy in the current environment. We believe that interest rates are fundamentally *too low*. We expect that will change within the next few years and we want to be prepared for the time when it does.

As such, we are letting our fixed income holdings mature and come closer and closer to turning into cash and cash equivalents. The investment yield from this is literally almost nothing so it is painful to be building cash. However, the investment yield of investing longer-term in fixed income is not much more. Just as an insurance underwriter needs to make a good risk/reward decision about whether to accept a risk or not, we must do the same thing in our investment decisions. We've concluded that we are not being paid adequately to assume the risk of owning longer-term fixed income securities so we are letting our cash balances build up.

We look forward to deploying this cash into longer-term and higher yielding investments when the opportunities inevitably present themselves. Meanwhile, we will wait.

At the same time, we continue to own a portfolio of equity interests, both passively through our public equity holdings and actively through our build out of the Markel Ventures operation. We believe that our companies represented by these holdings meet the four question test we discussed earlier and will prove to be durable and profitable businesses into the future. With the Alterra acquisition the size of our portfolio will increase dramatically. The addition of this portfolio and the growing cash balances create a "coiled spring" that we are looking to deploy and uncoil when opportunities present themselves.

The fantastic news is that the opportunity costs from taking this approach are as low right now as they have ever been given the low level of interest rates. As we see the "whites of their eyes" in investment markets we have more ammo to expend than ever before. This is a tough concept to quantify but it represents one of the most dramatic capital allocation and value opportunities that has ever existed at Markel.

Over time, we've compiled a record that should give you some confidence we will act rationally and produce good results for you as shareholders. Stay tuned for further developments…

### 3. We acquired Thompson Insurance Enterprises

In January of 2012 we completed the previously announced acquisition of Thomco. Thomco administered approximately 20 insurance programs in fields such as medical transportation, senior living, childcare, fitness clubs, pest control, inflatable rentals, and other specialty insurance lines. We're bouncing up and down with joy with the progress and benefits from this acquisition so far.

Greg Thompson and Bob Heaphey of Thomco have already broadened their roles during 2012. Greg assumed the role of President of Markel Specialty, and Bob became the Managing Executive of Thomco.

Thomco is a classic example of how we've added value to Markel shareholders over the years and created wonderful opportunities for the Thomco associates in the process. Thomco controlled approximately $170 million in insurance premiums and collected commission income in return.

As part of Markel, we've begun to underwrite this insurance through various Markel insurance company entities. We will benefit from Thomco's intellectual capital as we earn the associated underwriting profits from the business. We will also build investment assets from the associated insurance reserves.

Additionally, just as has been the case in our other acquisitions, the people of Thomco now have a permanent home with permanent capital to run their business. They also now enjoy broader cross selling and career opportunities than before.

### 4. We announced the formation of our partnership with Hagerty and the associated acquisition of Essentia Insurance Company

Hagerty is the premier insurance agency serving the classic collector car and boat market. Essentia Insurance Company underwrites insurance exclusively for the Hagerty customer base. We finalized the terms of our partnership with Hagerty during 2012 and we closed on the acquisition of Essentia in January 2013. We are now accepting the underwriting risks produced by the Hagerty organization.

McKeel Hagerty leads the second generation of the Hagerty firm. This partnership between Hagerty and Markel is yet another example of the value of the long-term nature of Markel and our well known consistent focus on building durable businesses that produce excellent results over long periods of time.

The Hagerty family chose Markel after extensive due diligence on their part to assure themselves that we would be quality partners in their business which they built over decades. The cognoscenti of the collecting world know and trust the Hagerty organization to meet their specialized needs in the world of collectible autos and boats. Hagerty believed that Markel would be the best possible partner to help them ensure that heritage continues into the future.

We are excited about the formation of this partnership and we look forward to reporting on its progress in the years to come.

### 5. We continued the successful integration of FirstComp

We acquired FirstComp in October of 2010. It is our operating unit which provides workers compensation insurance with a focus on smaller businesses. From the beginning, we were impressed with their customer service orientation, risk selection methodology, marketing skills, and use of technology.

Our initial plan at FirstComp was to provide their sales force with access to other Markel products which they could then sell through their extensive agency network.

Additionally, we hoped to benefit from their technological sophistication and improve our speed and efficiency throughout the rest of Markel. We expected an initial period of underwriting losses at FirstComp as we strengthened their reserves towards the levels we traditionally prefer at Markel and as we bore the expenses of integration.

We're happy to report that process has gone well. FirstComp is a key contributor to increased gross written premiums in 2012 and we believe that the business being written today is being priced to ultimately earn an underwriting profit. The marketing and technology expertise embedded in that organization is now working on behalf of the entire Markel organization and we are just beginning to leverage the cross sell potential of over 14,000 retail producers among FirstComp, Thomco and Markel.

## 6. We successfully implemented our data warehouse

*This is a major development.*

The combination of the pace of technological change, the complexity of our business, and our history of acquisitions with multiple legacy systems made the task of building a data warehouse challenging and this accomplishment marks a significant success.

During the second quarter of 2012, we went 'live' with our Wholesale data warehouse. This was the culmination of a multi-year effort to consolidate all of our Wholesale data into one reporting environment.

The warehouse has improved our ability to leverage our data in a number of ways. First, it has improved our reserving and pricing analyses, allowing us to more quickly assess the profitability of our books of business. It has also dramatically improved our reporting capabilities, making it easier to provide decision-makers with the information they need to manage their business. The warehouse also provides a platform for improved analytics, allowing us to drill down into our data and more easily determine the profit/loss drivers.

Finally, the warehouse provides a platform from which we can expand these capabilities into other areas of the business.

## 7. We enjoyed organic growth in insurance premiums

We enjoyed, and we do mean enjoyed, growth in insurance premiums in 2012. In 2012, gross written premiums totaled $2.5 billion, up 10% from $2.3 billion in 2011. Excluding premiums attributable to acquisitions, gross written premiums increased 6% in 2012.

We believe the growth in our premium volume largely stems from our efforts to improve our internal operations and our ability to serve our clients more efficiently. We've also enhanced and refreshed our products to provide greater value to our customers.

We've substantially increased our marketing efforts to reflect the breadth and depth of what we can offer to the marketplace and we've worked to increase the awareness of the Markel brand worldwide.

Organic growth was also driven by modest price increases during the year. While we still believe that the general level of insurance prices should be higher given the low level of interest rates and recurring investment income, we are pleased to see prices moving up rather than down. The underwriters throughout Markel have done a great job of exercising underwriting discipline and achieving pricing improvements.

## 8. We continued to report favorable loss reserve development

In 2012 we reported favorable reserve development of $399 million. In every report you'll ever see from Markel, which dates from the initial public offering in 1986, you'll see the statement that our policy is to establish insurance reserves at a level which is "more likely to be redundant than deficient." This is a key underlying value of Markel which goes much deeper than just the surface fact of positive reserve development.

The policy creates a virtuous cycle that is a relatively unique and a significant advantage for Markel compared to the insurance industry in general. First, it fosters a culture of conservatism and discipline which acknowledges reality rather than denying it. When you are making decisions it is always helpful (but often not fun or pleasant) to be dealing with real facts, and accurate data, as compared to what you wish things were like. In insurance, setting loss reserves involves making predictions about the uncertain future. We know that we will not be precisely right about the exact level of reserves needed. In the face of that reality what we do is to make every effort to err on the side of caution.

Second, conservative reserving practices help our front line underwriters make good decisions when it comes to quoting and pricing current business opportunities. Conservative loss picks help prevent underwriters from making inadvertent mistakes and underpricing new business.

Third, conservative reserving practices help our claims professionals as they seek to fairly and quickly settle losses when unfortunate events occur to our policyholders. No one enjoys having a loss. In the event of a loss, we want to assist our policyholders as quickly and as fairly as possible. By having conservative loss reserves set aside and ready for losses, our claims professionals know that they can do their job for our policyholders to the best of their ability and that senior managers will not wince at the payment of appropriate claims.

Our history indicates that we've accomplished the goal of consistent conservatism in the setting of loss reserves over the years, and 2012 was yet another year of this policy in action.

We've designed our incentive systems and we've spent years getting to know, and test, and trust, the senior leaders of this organization to make sure that your company is in the hands of people with a long-term orientation. If you want to test our resolve and fidelity in keeping this pledge to you, keep checking on our annual reserve development. It is a hallmark of a consistent, conservative, and prudently managed insurance organization.

### 9. We acquired Havco, Reading, Tromp and Idreco within our Markel Ventures organization

2012 was an exciting year in the ongoing growth and development of our Markel Ventures operations.

Total revenues for the group grew to $489 million versus $318 million in 2011 and EBITDA grew to $60 million versus $37 million a year ago. For a reconciliation of Markel Ventures EBITDA to net income to shareholders, see the table on page 108. While many of the Markel Ventures operations are cyclical and dependent on the overall economy, we are optimistic that we will achieve additional growth in bottom line profitability in 2013 and beyond.

Also, just as is the case in our insurance and other investment operations, we will be opportunistic in responding to and walking away from extreme prices. As we enter 2013, we do not expect to add substantial new acquisitions at Markel Ventures. Transaction prices are now moving up rapidly, and we will wait for better opportunities to show up before committing your capital.

Fortunately, we were able to add several businesses at attractive prices during 2012. We added Havco in April 2012, and they are off to a great start. Havco is the leading supplier of wood flooring for the trailer part of a tractor trailer, and we are delighted with their contribution to Markel. At Ellicott Dredge we added Idreco, a Dutch based dredge manufacturer. At ParkLand Ventures we increased the size of our footprint by over 30%. At Diamond Healthcare we opened a major new treatment facility in Williamsburg, Virginia, and at Partner MD we opened new offices and increased the number of physicians practicing with us by over 40%.

We also added Reading and Tromp to our existing AMF Bakery systems operation. These acquisitions continue AMF's process of becoming the preferred supplier of bakery equipment to food companies around the globe. AMF was the first company acquired by Markel Ventures, and we now begin our eighth year of operations together.

While baking is not a rapidly growing industry, in 2013, AMF should produce revenues and earnings that are up more than four fold since we bought the company in 2005. While this multiple expansion includes acquisitions, it also, and more importantly, reflects the advantages we offer to our Markel Venture companies.

Specifically, when we showed up at AMF, we empowered management to take a long-term view, and we reduced debt levels from those previously employed. Our goal was simple - we wanted management to focus on satisfying their customers with the best possible equipment and service levels, and we didn't want to have artificial pressures of near-term debt repayments and an unhealthy focus on short-term results to get in the way of this clear and simple goal.

Ken Newsome and his team responded magnificently to this charge, and they've been gaining market share and building the company ever since. We think we're just getting started there.

Throughout Markel Ventures, our management teams are working to build the recurring revenue and profitability of their firms and we are delighted with their overall progress.

We also want to express our thanks and our pleasure with the managers who joined us when they sold us their businesses. We have had NO turnover among the senior leaders who've joined Markel Ventures since inception in 2005. We think this speaks volumes about the clarity with which we've communicated our long-term goals and expectations for the businesses we bought, and for the desire of these managers to be able to build great companies unfettered by artificial constraints.

In many cases, these managers don't "need to" work but "want to" work and they do so because they are excited and dedicated to our values, and to the mission of building one of the world's great companies.

This is nothing different than what is true in our insurance operations, The Markel Style, and our multi-generational history of a focus on durable long-term values, pervades the operations at Markel Ventures, and attracts leaders who want to be part of this company to accomplish great things.

We are not for everyone. Being part of Markel requires a commitment to long-term values and a level of teamwork that doesn't suit some personalities. That said, if you want to be in an environment where you can excel, and be recognized and rewarded for doing so, Markel offers a unique opportunity.

With the scale created by the Alterra acquisition, our ability to continue to build Markel Ventures increases. We will be able to pursue larger opportunities, and we will be an attractive buyer to a wider set of potential sellers.

If you, or anyone you know, owns a business where the answers to our four investment questions would be good, and they want to be part of this organization, please give us a call. We are always looking for good partners.

## 10. We improved our operational performance in our insurance units as well as in our claims and shared services operations

Organic growth of 6% in 2012 gross written premiums is an encouraging sign that demonstrates the value of our operational and marketing improvement efforts that have been underway in recent years.

Markel International, under the leadership of William Stovin and his team produced outstanding underwriting results with a combined ratio of 89% and at the same time increased gross written premiums from $825 million in 2011 to $888 million in 2012. A lower combined ratio on greater volume is as good as it gets, and we thank and applaud the Markel International team for their results in 2012.

Our Wholesale unit, under the leadership of John Latham and his team, produced a combined ratio for the year of 94% compared to 86% in 2011 with gross written premiums of $956 million versus $893 million a year ago. This continues a long-term history of superb performance.

Our Specialty operation, now under the leadership of Greg Thompson and his team, produced a combined ratio for the year of 108% versus 109% in 2011 with gross written premiums of $670 million versus $572 million a year ago.

In all of our operations, we've focused on becoming easier to deal with. We've developed web based applications, broadened our product array, and proactively marketed our growing product breadth and depth to the global insurance marketplace.

Additionally, our increasingly effective analytical efforts are enabling us to refine our risk appetite on new business opportunities. We're increasingly able to understand where, and why, we should be raising prices to accept risks, and we're able to also better understand where, and why, we can lower prices, attract additional business, and still earn appropriate returns.

In general, industry prices remain too low and the returns on capital for the insurance industry are mediocre. We're proud of the fact that we've been able to increase the book value per share at good rates despite this headwind through continuing disciplined efforts in insurance, as well as better than average returns from our investing activities, and our growing Markel Ventures group.

We fully expect to be able to continue to earn good returns on your capital from the comprehensive activities of Markel Corporation. Economic activity and demand is increasing and industry capital is not growing at high rates. The lines of supply and demand are heading towards one another in a way that suggests insurance pricing may improve rather than decline.

We'll manage our operations to earn appropriate returns even if the industry doesn't cooperate, but we'll enjoy a season of higher overall insurance prices should that come to pass.

## Alterra

As we noted at the beginning of this report, 2012 was as full and busy a year as any that we can remember. Just before year end, we added to our 2013 and beyond "to do" list by announcing the acquisition of Alterra. Part of what we hope to do in this letter is to welcome the talented professionals of Alterra to the Markel family. We are excited about the new Markel Corporation that comes about as a result of this transaction and we look forward to building on our legacy of excellent financial performance with our existing and new colleagues.

This is a major transaction in the history of Markel and we'd like to discuss our reasons for engaging in this acquisition.

To state something obvious but important, Alterra is a quality insurance operation with a demonstrated track record of excellent underwriting performance. Underwriting profitability and reserve integrity are hallmarks of their organization as demonstrated by their years of consistent underwriting excellence.

Unlike many other insurance entity deals that Markel did in the past, this is not a troubled company with problems to be fixed and a new culture to be installed. Alterra has already demonstrated the ability to produce a consistent record of underwriting profits.

We believe that by joining forces, both the existing Markel organization and that of Alterra will be able to improve performance. We believe that we will both be better off as one company, as opposed to what either one of us could achieve as stand alone entities.

Among the reasons for our optimism about the long-term future of the combined entity is the fact that the new entity is a larger and more important firm in the global insurance world. Immediately, this moves us up the ladder in terms of opportunities that we will see to write business. Agents and producers look for the most efficient way to find coverage for their clients. The size and breadth of the combined entity will make it easier and more efficient for agents and allow us to meet more of our potential clients' needs. We'll see more business, and we'll be able to write more of the business we see.

Further, we'll have a larger balance sheet which will be more attractive to buyers of reinsurance and large global insurance programs. The combined entity will enjoy a higher profile and be a more attractive market for big limit insurance needs. We also will be able to optimize the returns that Markel shareholders should earn by offering our reinsurance and large account underwriters a culture of long-term underwriting profitability. This means that they will be able to write more business when marketplace conditions are favorable and just as importantly, if not more so, reduce writings and walk away from business when the rewards don't justify taking the risks.

We will be a large enough and diverse enough and, more importantly, mentally prepared to walk away from business when it is the right thing to do. This is what we've always done at Markel and this transaction is a force multiplier for the underwriting team at Alterra to improve upon their already solid results.

This mindset of focusing on the long-term discipline of only writing business that carries with it the expectation of an underwriting profit, as well as the reality of a larger and more secure balance sheet, will create a new and expanded set of opportunities for Alterra associates and Markel as a whole. Our new format should make the most of the circumstances.

While we are pleased with the early days of a trend towards improving our expense ratio, this transaction should increase the rate at which we enjoy increased operating efficiency. We will be writing more business with our existing infrastructure, and this should serve to lower our expense ratio in the years to come.

The transaction is immediately accretive to important metrics at Markel such as premiums, investments, and book value per share of Markel. We will recast the Alterra investment portfolio towards that of Markel's historical approach to investments, with our focus on prudent allocations to equities, ownership of controlled businesses, and a hawk like focus on extremely low investment management costs.

The new Markel offers all of our associates from our existing operations, as well as those of Alterra, new opportunities and challenges. While this is difficult to quantify, it is a huge factor in the long-term success of your company. We've taken on challenges before and we've stepped up to tackle bigger and bigger opportunities as time has gone by. In each of these circumstances a wonderful virtuous circle took hold.

Specifically, many of our associates rose to meet new challenges and gained skills and abilities that one can gain only by actually doing the work. Also, many associates from the acquired companies showed their skills and abilities and rose to new and broader roles within Markel over time.

The effect of this process is that the talent level, and bench strength, and skills of the organization continue to improve both from the development and growth of existing colleagues, and the addition of new talented colleagues. This statement applies to our senior leadership team in the same way as every associate of the company and vice versa.

This organic and eco-system like environment at Markel reflects a dynamic firm and not a stale or bureaucratic like system. The world changes at an ever increasing pace and we've got an organization that is designed to adapt and change along the way.

This is a huge reason why we've been successful in the past and will continue to adapt and grow in the future. Things don't stay the same. Fortunately, we know that, and we're willing to keep ourselves a bit agitated and never complacent about recognizing the need for ongoing change and growth.

Markel is an organization well suited for dynamic people who want to be challenged and grow. We are not a good place for people comfortable in a stable bureaucracy.

## The Beginning

There is no sense of conclusion at Markel. We are at a point of new and ongoing beginning. We understand that this letter is starting to feel like a book. However, 2012 was a phenomenal year for your company and it takes some time and space to describe the reality of what is going on around here. We were hard at work during the entire year building, rebuilding, tearing down, and rebuilding again, the very foundations of your company.

We acquired a wonderful operation in the case of Thomco, we added organic growth through the internal development of new insurance products and increased marketing efforts. We made breakthroughs in our multi-year challenge of developing an appropriate information technology environment to manage and conduct our business, and we earned wonderful investment returns. We raised the average IQ of our team by increasing the IQ points of the existing players through new challenges, and adding new associates who we hope are even smarter and more talented than we are.

Then after we did all these things, we announced the acquisition of Alterra, which will create a whole new level of opportunity for Markel and its shareholders.

Markel is an exciting place to be and we are proud of our long-term record of creating great value for our partners. Our partners are our associates, almost all of whom are shareholders, as well as the external shareholders who provide us with the capital, and the trust, and the time horizon, we need to continue our task of building one of the world's great companies.

Thank you for your support and confidence. We look forward to meeting the challenges of 2013 and beyond and we look forward to reporting our progress to you next year.

Alan I. Kirshner

Alan I. Kirshner, *Chairman of the Board and Chief Executive Officer*

Anthony F. Markel

Anthony F. Markel, *Vice Chairman*

S A Markel

Steven A. Markel, *Vice Chairman*

F. Michael Crowley, *President and Co-Chief Operating Officer*

Thomas S. Gayner

Thomas S. Gayner, *President and Chief Investment Officer*

Richard R. Whitt

Richard R. Whitt, III, *President and Co-Chief Operating Officer*

**Notes from the 2013 Markel Breakfast in Omaha**

**Tom Gayner (TG):**

- This is the 23rd year they have come out to Omaha
- Steve Markel was the architect of a firm that tried to make money from underwriting and make excellent investments as well
    - When Tom was talking to Steve about the idea, Tom realized there was a company that had done pretty well with that exact model—Berkshire Hathaway (BRK)
    - They knew that the people who were most likely to understand what they were trying to do were people who already owned BRK's shares
        - Decided to come to Omaha to try to meet like-minded investors
    - The first time they came here there were 6 people at the meeting
        - The stock price and the number of people at the meeting seem to be correlated
            - When there were 6 people at the meeting, the stock was $7-$8
            - Now that there are 400-500 people here, the stock is over $500

**Richard Whitt (RW):**

- Richard is the Co-President of Markel on the insurance side
    - He and Mike Crowley are co-presidents of insurance
        - Richard is an accountant by trade
        - He started at KPMG and his first client was Markel
            - He has been at Markel for 22 years
    - His job is to produce underwriting profits and premium volume to hand over to Tom and Steve to put to work in the investment portfolio
        - They want to get 3-5 pts. of underwriting profit so that Tom can do the sexy stuff

**Steve Markel (SM):**

- Steve Markel is the Vice Chairman of Markel
    - He likes being the Vice Chairman because nobody knows what you are supposed to do so you can do whatever you want
- Markel is at an exciting part of its history
    - Insurance pricing is starting to improve
    - They just completed a very major transaction
    - They are a small company but they have done some great things since they went public in 1986

- We all come back to Omaha so that we can be reminded of something that we had begun to forget
  - One comment that was made by Buffett that was a spark for him had to do with the fact that one of the great strengths of BRK is the shareholder base that understands the mission of BRK
    - Buffett was talking about this in the context of his succession plan
      - His point was that the Board is important but so is the shareholder base that would likely speak out loudly if people saw something happening that was off base
    - Markel has a great shareholder base that does not care about quarterly earnings
      - Allows them to make decisions that will pay off over the long term—not in 60-90 days
      - The Alterra transaction would not have been possible without a shareholder base that understood the reason for the deal and had patience
      - Markel is not for everyone and that is OK—they are not trying to appeal to everyone

**Q&A Session**

- David Winters: A cornerstone of the success has been the MKL style. How are you going to take that and get buy-in from the new acquisition?
  - TG:
    - The Markel style is a critical feature of the company
    - In the Jewish tradition, there is a concept of "it is written"
      - When the company went public, the founders knew that there would be a time when they would not have their hands on 100% of the business
      - There was an attempt made to make sure there would be something there after the founders were gone
        - The MKL value system has been codified so that it can last
    - As MKL Ventures and the non-insurance operations have grown, nothing about insurance specifically is included in the mission statement
      - The founders understood that things would change over time even if insurance was always the dominant part of the business
    - The 2nd word that was included in the values was "winning"
      - How do they teach that concept to others?
        - He would suggest that it is more fun to be on a winning team than a losing team
      - They have a ton of momentum and people want to be part of that
        - People understand what that entails

        - Because all of the MKL people have bought into it, they have a good gut feeling for people who are not wired that way
            - The organization rejects those people
            - Inevitably if someone is not working out, he/she will not last at MKL
- RW:
    - The first thing they talked about when they looked at Alterra was the cultural compatibilities
    - They have looked at a lot of acquisitions and many of them have gone into the “too hard” file because MKL didn’t think their cultures would work with the people at MKL
- SM:
    - Why is the strong value system so important?
        - They are not the smartest guys in the world and they try to copy the smart people
            - There have been studies that show that team players who share goals and objectives and are bonded do a lot better than a group of dysfunctional individuals
                - Shared values are a key element of MKL’s success
                - If you look at companies that are built to last, those that have a value system that people buy into inevitably do better
    - When they created the original mission statement, the shared value system was very important
        - They were going from a being a family-owned business to being a public company
        - The family business had a different set of values—those that correlated to a typical family business
            - Not all of those were appropriate for a public company
        - You need to separate the rights and benefits of shareholders from the rights and benefits of employees
            - They knew they had to focus more on shareholders
            - At the same time they wanted to create a system where employees would want to stay with the company for years
                - Allowed employees to become owners
        - They have been through a number of transactions where they have brought in a team to try to inoculate the new employees into the MKL style
            - It is always true that 10-15% of people won’t want to be a part of the MKL system
                - They are more interested in being a star than being part of a successful team

        - They want to find these people ASAP so they can encourage those people to work somewhere else
      - Then there are 20-30% of people who buy in immediately and they are able to influence the 50% who are on the fence
        - They send MKL people to the offices of the companies to explain the style
        - Markel compensation and incentive systems are implemented as well
- You have had great success investing in public markets. As you build the private market side of the portfolio, how do they source those ideas?
  - TG:
    - There are three buckets of buyers
      - Private Equity
        - These buyers can pay more than what MKL can
        - If you are only interested in the top bid, MKL is not the buyer
        - Private equity buyers will use more leverage and will sell the business in 3-5 years
          - Could lead to a lot of trauma and turmoil
      - Strategic buyers
        - These are people who are in the same business
        - These companies love revenues
          - They don't like expenses though—mostly people
            - You will not have two CFOs so many people will not be around
            - If those people are important to the success of the company, things will change—potentially for the worse
      - Investors with permanent capital
        - This is where MKL sits
        - MKL will not lever the company up
          - They will not sell it
          - They will buy assets that produce cash to buy more assets that produce even more cash
    - MKL's deal history
      - The first deal happened as a result of a local geographic accident
        - The seller was looking for Richmond-based buyer
      - The second deal actually came about because the attorney who represented the first seller called Tom and told him he had another client who was looking to sell
        - Made the deal at lunch and had a handshake by the end

        - As they get bigger and bigger, they are going to have to compete with more strategic and private equity buyers
            - They are willing to pay a full price for a great business
            - MKL sees a lot of deal flow because they know people
                - They also have relationships with middle market investment bankers
        - Of the 12 companies they have bought, their turnover has been 0% when it comes to the CEOs
            - That is unheard of
            - The sellers signed up a capital partner who was going to help the company grow the business
            - They have not had to fire people and sometimes the sellers become more invigorated once they do the deal
            - There aren't that many sources of permanent capital out there so they believe they have an advantage in some circumstances
- Buffett spoke about the importance of creating opportunities for women at the top of companies. What about the gender makeup of the board and the management team?
    - TG:
        - Tom feels good about where they are
        - There is one woman on the Board
        - The treasurer and CFO are both women
        - They are gender blind and gender neutral—they just want the best people
- Re-insurance is a tough business. Can you tell us how they got comfortable with Alterra's book of business?
    - SM:
        - Re-insurance is very challenging area
            - Getting exposure to it was a major part of the rationale for the acquisition of Alterra
            - If this business doesn't make underwriting profits, they will downsize it until it does
            - Reinsurance was a big part of the whole at Alterra
        - One of the areas that has become more channeling is where alternative sources of capital can enter—specifically hedge funds with side cars and/or catastrophe bonds
            - These forms of insurance are entering as investors look for uncorrelated risks
            - In the meantime, more traditional P&C lines remain very competitive
                - Over time these have been reasonably profitable though
        - They are interested in getting in growing this part of Alterra's business
    - RW:

        - He likes the reinsurance business they have now
            - Believe it will be better under MKL than it was under Alterra
                - Reinsurance made up 60% of Alterra's book but it will only be 20% of the new MKL
            - This is a scalable business and you can take a few people and write a lot on insurance
                - They are going to wait for their spots and are not keep tons of people around
    - TG:
        - There is an analogy from the investment world that fits here
            - Take 2 names from the portfolio
                - Caterpillar (CAT)
                    - Despite being a relatively buy and hold type of company, there are times when they buy this stock and times when they don't
                        - This is driven by the price, given that CAT has a somewhat volatile business
                        - There are times when people panic and others when people think the business will be growing forever
                            - They can take profits when they want
                            - They don't have to buy CAT—no one puts a gun to Tom's head
                - CarMax (KMX)
                    - This is a growth company
                    - Year in and year out you expect them to grow
                    - This is a stock you want to own and be in
            - All business is hard and successful businesses fight the good fight
                - The point is that like with CAT, when it comes to reinsurance they will pick their spots and only invest when they believe the pricing/timing is right
- BRK hired 4 key execs out of AIG. Is MKL small enough to stay away from pricing competition with these new players?
    - RW:
        - Those guys were going to be competing with MKL whether they were at BRK or AIG
            - But they are hunting elephants and he thinks that they will not be competing in the wholesale business with MKL
                - They will be competing with Ace, Chubb and Travelers

        - MKL would obviously rather have fewer competitors but no matter what the competitive landscape looks like they will remain disciplined in how they approach the business
  - SM:
    - Steve expects these people to be intelligent competitors now that they are at BRK
      - Maybe they will now be even more conscious when they underwrite
    - There are some questions surrounding AIG though
      - What will AIG choose to do to defend its turf?
      - Will they cut their price to maintain share?
    - His feeling is that MKL does not dominate this space and the fact that they are very small with insulate them
  - TG:
    - If everyone works for Ajit Jain and underwrites like him, MKL is likely to be fine
- Can you talk about how you go about trying to generate an underwriting profit?
  - RW:
    - You need the entire organization to share the goal of generating underwriting profits
      - They set their comp systems up so that people are compensated for underwriting profit, not growth
        - This tends to focus the mind
        - What that has meant is that they did not grow for a number of years as the market got softer and softer
      - The model they have created here does not work unless they make an underwriting profit
        - Have an intense focus on making sure underwriting profits get made on a consistent basis
        - They have some really good underwriters at MKL
          - They are attracted to MKL because they are allowed to do their business
  - SM:
    - Underwriting profitably is always a challenge
    - They want to generate 3-4 pts. of underwriting profits
      - With rates so low, solid underwriting is really important
      - Buffett talked about the importance of risk selection and suggested that the pricing of risks is paramount
        - You should make a profit if you charge the right price
          - This comes from having smart people who become experts in the lines they are writing

- You need an information system that allow you to see differences between lines of insurance
- Retention allows you to understand risks better over time
- In the children's summer camp business, for example, they have renewed certain policies for 8 to 14 straight years
  - When you have written that business for that many years, you are able to price it better
  - If you are giving great service, then camps are willing to pay a fair price
  - This is a small example but in all cases their underwriters only write when they can make money
- TG:
  - When he came to work for Steve, they talked about how to make an underwriting profit
    - They have done so more often than not for 27 years
  - No insurance executive will ever say he/she doesn't want to underwrite profitably
    - But the market only gives you credit when you do it consistently
    - They have made acquisitions in which they had to change the culture
- What company is Tom Gayner's See's Candy?
  - TG:
    - Of the dozen they have bought there are 3 that apply here
    - AMF is one
      - AMF was a $50M business when they bought it
      - Before that transaction, it had been operating as a levered business
        - It was a good business with a bad balance sheet
      - They reduced the leverage but there was more to it than just that
        - When a piece of equipment broke, you had unhappy customers and they were servicing a lot of debt
        - MKL focused on developing a reputation for making sure things were fixed and worked well
          - The reputation kicked in an it gave them increased pricing power and market share
      - Baking is not a fast growing business but that company is going to do 4-5x what it did when it was bought
        - Some of that was organic and some was through tuck-in acquisitions
        - They are earning good returns on capital in a non-growth business

        - The next business is Parkland Ventures
            - Started out as just an idea and they have gone to 41 parks from just 4
                - Think there is a huge runway for growth as there are 41K parks in the US
        - The last business is PartnerMD, the provider of concierge medical and executive health programs
            - They had 9 physicians when they bought this
                - According to BLS, there were 113K physicians in the US
                - Think there is a long runway here too
- Jeff Stacey: Can you talk about differences between the Terra Nova and Alterra acquisitions? Is there a situation where they would buy another fixer upper?
    - RW:
        - They are very different companies
            - Terra Nova had been built quickly to be sold
                - The pieces had not been integrated
                - MKL knew all this but did not understand the depth of the issues
                    - This was a challenging situation
            - Alterra was built through acquisitions
                - It was clear that they would need a partner in order to grow
                - It was clear that this was a very different type of organization
                    - They had great controls and a good underwriting culture
                - There will always be surprises
                    - But MKL won't be surprised because of poor blocking and tackling in underwriting
                    - There are a lot of good people at Alterra—they have kept all of the top people
                - He feels really good about the people and the business
    - SM:
        - The Alterra transaction is one where they paid a full price for a quality company
            - Terra Nova was a fixer upper they bought much cheaper
        - In the near term they have their hands full so they are not likely to make a big insurance acquisition
            - The idea of buying a fixer upper at the right price is not a bad thing though

- Can you spend some time talking about the big risks on the asset side of the balance sheet that exist in the insurance industry? Are there too many people stretching for yield?
    - TG:
        - He doesn't sleep well at night because he is worried about MKL's assets—he doesn't have time to worry about the whole industry
            - One of the worries that he has is that rates will go a lot higher
            - The regime of low rates does not make sense to him
        - The bond portfolio duration continues to shrink and becomes more like cash
            - This adds a lot of optionality—they are really liquid and can deploy cash
            - Normally they would be giving up yield but the opportunity cost of using that strategy is very small
                - The difference between 1bp and 8bps is irrelevant
            - It is important to have cash when others don't
                - He doesn't know when but we will be in a different environment at some point
                - The Alterra portfolio has a longer duration
                - The MKL portfolio's duration is at 2.5 now versus 4-5 in the past
                    - It has never been this low
                    - They usually try to match their insurance liabilities and assets but now those are not matched
- As you search for private companies, you say that you are buy and hold-focused. How do you determine that the products or services of these companies will not go obsolete?
    - TG:
        - BRK bough ACME Brick years ago because Buffett knew that 10 years from then a brick was still going to be a brick
        - Tom tells his people that they don't want to own a business that could be gone in one morning
            - Bakery equipment is not going away tomorrow
                - People are going to continue to eat bread
            - Manufactured houses that are low cost are very necessary
        - They bought a dorm room furniture company a number of years ago
            - They had a Board meeting after this deal and the Board members were wondering if Tom had any specific industries he was looking at
                - The answer is no
                - They simply buy large companies in small industries that throw off a lot of cash
                    - They also want businesses that don't change much

            - So, the next business they bought was Ellicott Dredge
                - You can't dredge over the internet
        - In general, they are able to immediately recognize whether a company fits or it doesn't
- Can you talk about some of your long tail insurance businesses and the cyclicality inherent in them? How about medical malpractice specifically?
    - RW:
        - Each market has its own cycles
        - Medical malpractice is a business they have been in for a long time
            - Are seeing modest price increase in some lines but medical malpractice is very competitive
            - When St. Paul pulled out a few years ago the market got really hard and the market has performed really well since then
                - Now it is a slugfest and premium volume that was $200M has come down to $80M to maintain margins
        - Markets tend to move in the same general direction
            - In some of the other casualty areas where there have been losses, you are starting to see mid-single digit rate increases
    - SM:
        - They like longer tail businesses because they generate more float
            - But they still want high margins in the long tail businesses
        - A disadvantage of long tail business is the inflation risk
            - They need to think about whether costs of claims will go up or down over time
- CarMax has standard pricing and uses a lot of data. Tom, what stops others from replicating their model?
    - TG:
        - There is no question that there are other major dealer groups that push through a lot of volume
        - But mindset is really important here
            - CarMax reminds him of a story about RH Macy of Macy's
                - Clearly Macy's has a name that still matters
                - RH Macy was a Quaker merchant who worked on whaling ships
                    - Quakers were merchants who sold at fixed prices
                - RH Macy went to NY in the 1800s and because he was willing to sell at a fixed price as opposed to through a haggling system, he was able to put ads in the newspaper with firm prices
                    - The rest is history as this is commonplace now
                    - But it took a long time for competitors to do this

        - The fixed price offer from CarMax is the key
            - No one has done it at the scale that CarMax has
            - It is not a secret what they are doing
                - It is just hard for the competitors to let go of the old model
- One of the advantages is that MKL invests in other insurance companies. What is the outlook for their other insurance companies?
    - TG:
        - They have a good allocation to financial and insurance companies
            - Hold BRK and Fairfax Financial (FFH)
        - There are a lot of other insurance companies that he respects
            - Underwriting discipline has gotten better across the industry
                - You can't make up for bad insurance operations with investment returns in this low rate environment
- Why buy Alterra now? How did it come about? Why did they pay with stock?
    - SM:
        - They had been following Alterra for a long time
            - Knew the shareholder base and the leadership team
            - Knew that it would come to market at some point so they were not surprised
        - The senior team consisted of a good group who had done a nice job
        - Paid $3B to acquire Alterra
            - Would rather have used all cash but they didn't have $3B in cash so they needed to issue stock
                - They think that the value they are getting is bigger than what they paid
            - The overall benefit suggests that the deal should be accretive to book value per share
                - The cost savings from moving the company from Bermuda to the US should help
            - The shares issued represent about 30% of the total outstanding
                - The two largest shareholders were Chubb_Corporation and a hedge fund
                    - As it relates to the hedge fund, ultimately the private funds will be dispersed to the underlying investors
    - RW:
        - When they first looked at it they thought there was going to be a lot of overlap between businesses
            - What they saw was that they would pick up 2 businesses that they did not have before

            - The business that they did have in excess and surplus was very complementary
        - It is a $2B portfolio with some overlap but they believe they can renew a lot of that over time
        - The ability to add to the investment portfolio was important too
    - TG:
        - Their share count has been coming down as they have bought back shares
            - They will continue to do that
        - Buffett talked about Henry Singleton at Teledyne and how he used shares in a lot of transactions
            - They know this story well and understand the risks
            - But we have to remember that when he joined MKL, the investment portfolio for $45M
                - Now it is in the billions
                - They would never have had the business they have now if they had not used equity capital
                - They would love to write $3B checks—but they can't now
                    - As they get bigger, their bias is to use cash
                    - They will always be thoughtful about allocating capital

- Why wouldn't they put more of the investment portfolio into equities than bonds, given the low expected returns for bonds?
    - TG:
        - Regulatory issues are important here
            - They will have the liabilities over-collateralized by fixed income for the next 5 years
                - They want to have bonds coming due so when claims come in, they have cash
            - He has no idea what is coming around the corner
                - But he knows he wants to be around for the next round of the fight
            - He loves Richard and Steve because they have never--in 23 years--asked for money back after they gave it to him
                - MKL construct the operations in a way that they don't put liquidity demands on their equity capital
                - There were "bigger" and "smarter" companies that are no longer with us because they could not meet liquidity requirements
                    - Want to be in the game tomorrow so they can take advantage of distress

- If the noninsurance business were running outside of MKL, would they have an ROIC of 20% or more?
    - TG:
        - Yes, but you have to understand the accounting
        - If you are looking at bottom up versus top down accounting, the company can look very different
            - You have to look at what the companies would earn intrinsically before considering the corporate tax rate
            - EBITDA is not the whole answer when it comes to measuring cash flows and returns because you need to think about the level of CAPEX
                - If you own a radio station, EBITDA is an useful measure
                    - Not so much in steel companies
- What is your opinion of the recent Brookfield spinoff? What is his opinion of Watsa's hedging at FFH and the deflation trade?
    - TG:
        - In terms of BAM, he thinks it is a fascinating company
            - BAM is their largest holding
            - He has great respect for the management team
            - He does not know about each of the "daughter ships" but he trusts the management team at the BAM level
                - They have a multi-decade track record of creating value for shareholders
    - SM:
        - They have had a long term relationship with FFH
            - Over the last several years that has just entailed MKL being a shareholder
        - Prem Watsa is one of the smartest guys around
            - They are familiar with his equity hedge and his deflation hedge
            - They do not share his concerns to the extent that they would do the same thing at MKL
            - They have a lot of respect in his judgment but will not hedge their equity portfolio or worry too much about inflation
        - These positions are basically insurance policies for FFH
            - They are not big bets that bad things will happen
    - TG:
        - Tom wears the same tie to Omaha each year
            - He bought it a number of years ago and it has a picture of stamps on it—the domination is a nickel
                - Clearly there has been inflation in stamp prices
        - Tom understand why Prem is scared of deflation—look at what has happened in Japan

            - But Tom thinks we live in a period of fiat currency and doesn't think deflation is likely to be a problem
                - The economic forces of deflation have a counterbalance to what central banks are doing for sure
                - He doesn't know who wins but he thinks over time that we will have inflation
- Pat Brennan: How should we think about the CAGR-related compensation metrics in the proxy statement?
    - SM:
        - The most important thing to think about is that over a long period of time, they have gone out of their way to try to make sure the shareholders get a fair shake
            - This will remain a part of their culture when it comes to compensation
            - They will not have extravagant comp for their leaders
            - All of the formulas are moving targets given that interest rates (and this rates of return) will move around
                - They will err to make sure the shareholders get a good return though
    - TG:
        - He would hope that if the roles were reversed, shareholders would be happy with the MKL compensation plan
            - They are not going to grant a lot of options when the stock price goes down
            - But they have re-set the threshold lower in terms of what they have to earn for the execs to get a bonus
                - It is still a pretty high return required and that will increase as rates go up
            - They made some adjustments so that Tom and Richard could receive a bonus
                - They are still compensated based on 5 year rolling averages
        - This is a season in which they are reading proxy statements
            - Exxon (XOM) is a great company to look at
            - Being the Chairman at Exxon is very hard job
                - The Chairman makes $25M
                    - Comparing that to what a lot of corporate execs make, he thinks Exxon shareholders are getting a good deal
                - Of that main compensation, the max amount you can get in cash is ½
                    - The rest is in stock

                - The vesting period is the longer of 10 years or until retirement
                    - If you are 40 years old, the vesting period could be 25 years
                    - If you want to be a senior at XOM, you have to be willing to stay decades
        - He thinks MKL's proxy statement gets an A grade
- What is the impact of long term bond rates on what they can now earn on their fixed income book?
    - SM:
        - Bond returns have been a large portion of their returns over the years
        - Low rates are a fact or life
            - If rates on bonds stay low they will have to figure out how to make returns elsewhere
                - If rates go up, there will be some pain but they have short duration bonds
                    - As rates go up, they will also have the opportunity to earn high rates again
        - Their goal is to make high ROICs
            - They will have to make more returns from underwriting operations if rates stay low
                - The combined ratio goal will go from 90-95% to 85-90%
            - They will also give more money to equities and to MKL Ventures
            - They expect to figure out ways to earn high ROICs
    - TG:
        - If rates stay low, yields will be so low that they will earn less
        - But they have an 8 cylinder engine—not a 4 cylinder one
            - They have a lot of businesses that can do well at any given time
- Bob Robotti: What are they seeing in the manufactured housing market? Do they also finance these houses as well? Is there room for expansion?
    - TG:
        - They are able to create a homemade corporate bond portfolio
            - They provide debt capital to MKL Venture companies as well as equity capital
                - If they can get a 6% coupons on this debt, it is a lot more than they can get investing in other things
            - They want to find businesses that they have a lot of confidence in
                - They would rather lend to their own businesses at 6% than buy Apple bonds
                - The companies clearly need to maintain robust organizations that can handle the debt

      - But, some of their businesses have capital intensity and it might make sense for MKL to create an in-house fixed income book
- Can you discuss the intrinsic value of MKL and how that compares to book value (BV)?
  - TG:
    - BV is easily calculable
      - On this metric, they have usually sold at a small premium to the industry
        - They have a good track record of returns
        - The premium has diminished over the years
    - As MKL goes forward, you need to think about more than just BV
      - Growth is BV is a good proxy for the growth in intrinsic value
        - But it is not a precise measurement of the intrinsic value of a company
    - He would look at MKL from an SOTP basis
      - Look at the holdings and add those up
      - MKL Ventures throws off cash flow that can add to how much MKL can compound over time
      - You have to pick a discount rate to see how closely intrinsic value resembles BV
      - For the businesses that generate cash, BV is not a very good valuation measure
        - See's Candy does not have a high BV but it throws off a lot of cash
        - Proctor & Gamble (PG) is a great company as well
          - It trade at a premium to book value and they use some of the capital the business generates to buy back stock
            - As a result, PG has a negative tangible book value
              - He would buy PG for a negative value for sure
- On the topic of MKL Ventures, can you elaborate on what you have learned from past acquisitions?
  - TG:
    - The size and scale of the deals has changed over years
      - Good judgment comes from experience, which comes from bad judgment
    - You make better decisions as time goes buy
      - They are getting better as time goes by at making large capital allocation decisions
    - Gayner is a control freak

            - They know they don't want to be a minority shareholder
    - SM:
        - They are still in the crawl phase when it comes to MKL Ventures
            - But they know they like to have a control position versus a minority position
- What about innovation in the insurance industry? What systems does MKL have in place to encourage innovation?
    - RW:
        - Alan Kirshner (the Chairman of MKL) has challenged them to become a more information driven company
            - Many industries have become very information-focused
        - They are trying to get better at using the information they have to make underwriting and marketing decisions
            - They have a ways to go on this—so does the industry as a whole
        - They are a specialty insurance company
            - Will not go toe to toe with the larger, commodity players
            - One of the ways they can innovate is by acquiring
                - When thy acquire, they get talent
                - Growth leads to innovation—bringing people in who can grow into other specialty areas
    - SM:
        - As society grows and evolves, it creates new needs for insurance
            - Cyber security is an example of that
        - The areas of data mining and looking at correlations are a large focus
    - TG:
        - The world changes and they know that they have to change with it
- Closing Remarks by Tom Gayner
    - There are 3 principles of capital
        - Having more is better
        - The best way to get more capital is to earn it—not to raise it
        - You need to have a relationship with the capital markets that leads to quality a shareholder base
            - Having just that allows MKL to run its business without short term pressures
                - These investors only care about MKL doing the right thing over the long term

# 2013

## To Our Business Partners

Here is our annual report for 2013. Each year we write this letter to update you on the financial performance of your company and to qualitatively describe what went on at Markel. This is your company. We as managers are stewards of your capital. You've entrusted us with the authority to run this business, and this annual report functions as our report card to you. As John Cheever said about a kiss, "You can't do it alone." We thank you for your partnership and the opportunity to do this because among other things … it's fun.

Part of what makes it fun stems from the fact that 2013 was a year of fabulous financial performance. Financial results are a scorecard that measures one dimension of how good we are at doing our jobs. We like to think we are good at what we do, and it is pleasant to be able to report outstanding financial results and good marks.

Here are the headlines for 2013. Total revenues increased 44% to $4.3 billion, we earned comprehensive income of $459 million, and book value per share grew 18% to $477.16. We transformed the company by almost doubling the size of our insurance operations with the acquisition of Alterra on May 1st and we are pleased with the pace of our integration efforts.

When we announced the Alterra acquisition, we emphasized the idea of "*scale enhanced, business as usual.*" We said this to give comfort to our insurance customers while we addressed the integration of the two companies, but we also think it is an equally compelling message for our investors.

This is a long letter. It takes a bit of time to update you on how things progress each year. If you just want the Twitter version of less than 140 characters, here it is …

*2013 a great year. Doubled insurance business with Alterra acquisition. Rest of Markel grew by double digits. Expect more over time.*

More important than any one year, is the long-term record of compounding the value of your company over time. As we have for many years we start this letter with a 20 year compilation of our most important financial measures in the table below. As is always the case, the

| *(in millions, except per share data)* | **2013** | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| Total operating revenues | $ **4,323** | 3,000 | 2,630 | 2,225 | 2,069 | 1,977 | 2,551 | 2,576 | 2,200 |
| Gross written premiums | $ **3,920** | 2,514 | 2,291 | 1,982 | 1,906 | 2,213 | 2,359 | 2,536 | 2,401 |
| Combined ratio | **97%** | 97% | 102% | 97% | 95% | 99% | 88% | 87% | 101% |
| Investment portfolio | $ **17,612** | 9,333 | 8,728 | 8,224 | 7,849 | 6,893 | 7,775 | 7,524 | 6,588 |
| Portfolio per share | **$1,259.26** | 969.23 | 907.20 | 846.24 | 799.34 | 702.34 | 780.84 | 752.80 | 672.34 |
| Net income (loss) to shareholders | $ **281** | 253 | 142 | 267 | 202 | (59) | 406 | 393 | 148 |
| Shareholders' equity | $ **6,674** | 3,889 | 3,388 | 3,172 | 2,774 | 2,181 | 2,641 | 2,296 | 1,705 |
| Book value per share | $ **477.16** | 403.85 | 352.10 | 326.36 | 282.55 | 222.20 | 265.26 | 229.78 | 174.04 |
| 5-Year CAGR in book value per share [1] | **17%** | 9% | 9% | 13% | 11% | 10% | 18% | 16% | 11% |

[1] CAGR — compound annual growth rate

numbers in this chart stem from the unique financial architecture in place at Markel. We've earned wonderful returns on your capital over decades. One reason for that is that each year, and in fact, each day, we get to choose from a varied menu as to how to allocate capital to continue to build the value of your company. Most companies do not enjoy the 360 degree range of choices we do to build value.

Our first and favorite option is to fund organic growth opportunities within our proven, existing line up of insurance and non-insurance businesses. Our next choice is to buy new businesses. Our third choice is to allocate capital to publicly traded equity and fixed income securities, and our final choice is to repurchase shares of our own stock when it is attractively priced and increases the value of each remaining outstanding share.

In 2013 we did all four of those activities just as we have for several years. The execution of our daily business against that framework is what produces the results we've earned for you over time and display for you here.

We are proud of this record and we hope that you as the long-term owners of this business are as well.

In the balance of this letter, we'll organize things by commenting on each of the elements of this table. We hope to give you some sense of how we produce these excellent financial results over time, as well as providing you with some insights into the non-financial factors that give us confidence we can continue to earn your trust in running this company.

One of the key features that help to produce these results over such long time horizons is the sense of teamwork that exists at Markel. Jim Collins in his book "Good to Great" noted that organizations tend to cluster around two basic models, "teams" or "a genius with a thousand helpers."

Markel functions as a team. We've got a deep and growing roster of skilled players. We know that on a team different players assume different roles and responsibilities. Sometimes it means scoring points, sometimes it means passing the ball to someone else, sometimes it means teaching a new player how to do something, and sometimes it means driving the van to the next game.

Those roles can and do change over time. We believe that teams last longer and produce better, more durable results than the "genius with a thousand helpers" model. We love the team of our colleagues and long-term shareholders, and we hope the following discussion of our key financial measures will provide some insight into that reality and how it works at Markel.

| 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 20-Year CAGR[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ 2,262 | 2,092 | 1,770 | 1,397 | 1,094 | 524 | 426 | 419 | 367 | 344 | 280 | 235 | 16% |
| $ 2,518 | 2,572 | 2,218 | 1,774 | 1,132 | 595 | 437 | 423 | 414 | 402 | 349 | 313 | 13% |
| 96% | 99% | 103% | 124% | 114% | 101% | 98% | 99% | 100% | 99% | 97% | 97% | — |
| $ 6,317 | 5,350 | 4,314 | 3,591 | 3,136 | 1,625 | 1,483 | 1,410 | 1,142 | 927 | 622 | 609 | 18% |
| $641.49 | 543.31 | 438.79 | 365.70 | 427.79 | 290.69 | 268.49 | 257.51 | 209.20 | 170.95 | 115.45 | 112.55 | 13% |
| $ 165 | 123 | 75 | (126) | (28) | 41 | 57 | 50 | 47 | 34 | 19 | 24 | 13% |
| $ 1,657 | 1,382 | 1,159 | 1,085 | 752 | 383 | 425 | 357 | 268 | 213 | 139 | 151 | 21% |
| $168.22 | 140.38 | 117.89 | 110.50 | 102.63 | 68.59 | 77.02 | 65.18 | 49.16 | 39.37 | 25.71 | 27.83 | 15% |
| 20% | 13% | 13% | 18% | 21% | 22% | 23% | 26% | 26% | 31% | 17% | 25% | — |

## One - Total Operating Revenues and Comprehensive Income

You might notice that we have two items listed here, revenues and comprehensive income. While we start off the 20 year table just with the label "Total operating revenues," we believe we should discuss comprehensive income at the same time. It would be a mistake to celebrate one without the other. In the insurance business, revenues can be easily obtained. All you need to do is cut prices and charge less than the ultimate underwriting losses. The world will beat a path to your door to pump up your revenues. You will also soon go broke. Any and all revenue must carry with it the expectation of profitability. In our insurance operations profits are measured by underwriting profitability. In our investment operations profits are shown as total investment returns. And at Markel Ventures operations they are demonstrated by EBITDA and net income.

We are focused on the long-term creation of value at Markel. We therefore focus on bottom line profitability over multiple year periods, not just short term increases in total revenues. Our compensation as senior managers, and our wealth as fellow shareholders of the company, depends on *profitable* revenues, not just revenues. That said, when it comes to profitable revenues, more is better.

In 2013, just such a happy thing occurred. Revenues rose 44% to $4.3 billion versus $3.0 billion in 2012. This total comes from earned premiums of $3.2 billion, net investment income of $317 million, net realized investment gains of $63 million and other revenues (primarily from Markel Ventures) of $711 million. This recitation of these amounts sounds so easy to say, and the numbers are so straightforward, that it is easy to forget how much work goes into creating total revenues of $4.3 billion.

In 1930, "Red" Motley said, "Nothing happens until somebody sells something." Each and every associate of Markel is a salesman in some form or fashion. We mean this as high praise and we salute the hard work involved. Each and every one of those $4.3 billion dollars (or pounds, euros, krona, pesos, reais) meant that someone in Markel connected with a customer who needed our products or services. They explained how we could meet their needs. They provided insurance coverage, or mechanical equipment, or products and services that our customers wanted and needed. Additionally, they satisfied our customers, as demonstrated by our having so much repeat and renewal business. The customers came back again and again. We must be doing something right.

Our 2013 revenues of $4.3 billion were a new high water mark for Markel. To give you some sense of perspective, ten and 20 years ago our revenues were $2.1 billion and $235 million respectively. While we focus on bottom line profitability rather than top line revenues, there would be no opportunity to produce bottom line profits without revenues coming in the door.

We'd like to thank all of the associates of the Markel Corporation who serve their customers by producing the incoming top line revenues of the business. It represents immense effort, and we are grateful for their skills and dedication. We cannot begin to do anything that creates value for you as shareholders without revenues coming in the front door.

Our comprehensive income totaled $459 million in 2013 and book value per share grew 18% to $477.16 compared to $403.85 at the end of 2012. The five year compound annual growth in book value was 17%.

*We think that the growth rate of our comprehensive income per share over time is one of the most important financial metrics at Markel. While it will vary from year to year due to external market fluctuations and economic cycles, we think that this measurement over multi-year periods is the best way to measure our economic progress.*

In the past we've headlined our book value per share, while at the same time noting our five year compound annual growth rate in book value (CAGR). Starting this year, we'd like to shift the emphasis more towards the five year CAGR rather than the static book value amount.

The reason for this subtle shift is that while the insurance businesses of Markel remain tethered to the reasonably accurate GAAP accounting balance sheet definitions of book value, our growing Markel Ventures operations are more accurately valued by considering their generation of cash as shown on the consolidated statements of income and cash flows. Also, capital management activities such as share repurchases, and share issuances in acquisitions, affect the calculation of raw book value.

We believe that the five year change in book value is now just as important a measurement to consider when thinking about the value of your company as the book value itself. We'll describe our reasons for this statement later in the letter as we get to the always treasured accounting discussion. Stay tuned!

## Two - Gross Written Premiums

Gross written premiums rose 56% in 2013 to $3.9 billion from $2.5 billion in 2012. Organic premiums from existing Markel operations rose 7%. Gross written premiums also increased due to the Alterra acquisition, with premiums from those operations included for the last eight months of the year.

Each and every insurance unit within Markel produced excellent results in 2013.

Our Excess and Surplus segment, which includes our wholesale division led by John Latham, produced gross written premiums of $1.1 billion in 2013 versus $956 million in 2012, an increase of 12%.

We thank John for his exemplary leadership of the wholesale business and we wish him the best in his upcoming transition to a well-deserved retirement in 2015. We're also delighted that Bryan Sanders, who joined us as part of the Alterra acquisition, will assume leadership of our wholesale division and that the two of them will be working together this year during the transition.

The outstanding growth in our wholesale operations reflects the ongoing efforts of our technology and business leaders to make Markel easier to do business with. While we always operated creatively, and worked diligently to figure out ways to assist our insureds with unusual insurance needs, we had room for improvement in business processes and technology. We've made great strides in this area in recent years, and we are now beginning to see tangible benefits of more business and lower expense ratios as a result of these initiatives.

Our Broker Portal initiative stands as a great example of a successful initiative. With this web-based system we can process more insurance business faster and with lower expense than ever before. With Broker Portal and other ongoing business process improvements, we expect ongoing increases in our ability to write more business at lower expense ratios in 2014 and beyond.

Our London Insurance Market segment, which includes the Markel International operations led by William Stovin, produced gross written premiums of $914 million in 2013 versus $888 million a year earlier, an increase of 3% compared to 2012.

Markel International continues to spread its wings around the world with growing businesses in Continental Europe, Asia and also, as a function of newly acquired capacities from Alterra, Latin America.

Markel International completed the acquisition of Abbey Protection plc in January 2014. Abbey provides legal and tax services to its clients along with related insurance coverages. We plan to focus on cross selling between Abbey and our existing Markel International UK customer base. We also expect to expand its business geographically over time.

Our Specialty Admitted segment includes the operations of our Markel Specialty division and is led by Greg Thompson. Greg and his team produced gross written premiums of $900 million in 2013 versus $670 million in 2012, an increase of 34%.

During 2013 we focused on streamlining business processes, cross-selling, and building the value of the Markel brand in the marketplace. We also became the premier insurer of classic automobiles through our underwriting relationship with Hagerty.

With the Alterra acquisition we added several complementary products to our existing wholesale and Markel International divisions. We also added two new divisions, Global Insurance and Global Reinsurance.

The Global Insurance division, led by Lou Adanio, John Boylan, Jim Gray and Mike Miller, produced gross written premiums for Markel of $275 million in 2013. The Global Insurance division provides insurance coverage to larger entities than we previously served at Markel on a worldwide basis and stands as a good example of our expanded capabilities as a result of the Alterra acquisition. We are very pleased with how the insurance marketplace has responded to our offerings. The business grew despite the distractions and disruptions involved in any acquisition. As we enter 2014, we believe the distractions of the deal are behind us and the benefits of the larger balance sheet and market presence continue to build.

The Global Reinsurance division, led by Dave Kalainoff and Jed Rhoads, produced gross written premiums of $408 million for Markel in 2013. We are excited about the long-term prospects for this new business.

Today, reinsurance faces some of the most competitive marketplace conditions in our insurance portfolio. Despite that, we expect ongoing profitability in 2014 and beyond. With our new, larger balance sheet and longstanding commitment to underwriting profitability and dependability in the marketplace, reinsurance should be able to grow in well priced insurance markets and produce large profits in some years. In other years, we will reduce writings when we are not being paid appropriately to take risks.

Over time, this culture and discipline at Markel has served us well. Reinsurance in and of itself is neither a good or bad business. What can make it good is that, in certain markets, we can write a lot of profitable premium volume and compound the returns from doing so with our investment activities. In tough markets we will need to be extremely disciplined and willing to walk away from underpriced business.

We've practiced this discipline throughout Markel over the years, and we will continue to do so. The combination of our long-term focus, discipline, and diversification allows us to be patient. We are not dependent on any one product or customer. As such, we can increase or decrease our exposures as market conditions warrant and we are used to doing this. We expect the cumulative results from doing so will demonstrate the wisdom of growing our reinsurance business and creating value over multi year periods.

## Three - Combined Ratio

No discussion of gross written premiums makes sense without discussing the combined ratio and profitability of those revenues. We've got good news on that front as the overall combined ratio at Markel was 97% in both 2013 and 2012, despite the fact that we incurred two points of non-recurring expense related to the Alterra acquisition. While we benefited from a relatively mild year with lower than normal weather-related catastrophes, we are pleased with these results.

We also remain committed to our unchanging standard of conservatism in setting our loss reserves and doing our best to make sure that we remain "more likely to be redundant than deficient" in our balance sheet accounts. We are booking the Alterra business with a margin of safety consistent with our long standing practices, and we will continue to do so. This approach protects the balance sheet, and in our opinion, the value of your company in many dimensions. It also tends to produce more volatility in year-to-year results. So be it. We think it's the right way to proceed.

In 2013, we wrote more business than we've ever written before, and we did so at a profit. A number of factors produced these results. One, the underwriters throughout our organization thoughtfully and skillfully selected and priced the risks we take very well. Two, they were able to do so because the information technology that supports their efforts improved during the year and they had more data with which to make decisions. Three, the increased size and scale of Markel gave underwriters more opportunities to see and write business than ever before. Four, the marketing efforts to establish the Markel brand in the insurance world increased our opportunities to see and write business. Five, our financial performance and reputation gave our clients confidence to trust us to be there when and if a claim occurred. And so on and so on and so on ...

We believe that these are persistent advantages and we will continue to build on them over time.

## Four - Investment Portfolio

At year-end 2013, the total investment portfolio reached $17.6 billion compared to $9.3 billion a year ago. The acquisition of Alterra added $7.9 billion on May 1st. Interest rates bottomed out for the year almost exactly on the May 1st closing date of the Alterra acquisition. The subsequent rise in rates during the rest of the year reduced the carrying value of the portfolio which offset increases in the portfolio from our investment performance and cash flows.

The highlight of the year in our investment portfolio was the 33.3% return on our equity investments. Over the last five and ten years we've earned 21.6% and 12.4% respectively per year on our equity portfolio. These are outstanding investment results. Most insurance based organizations do not invest in equity securities to the extent we do at Markel. Our equity portfolio has added immense value to our total returns over many years and we think our long standing and consistent commitment to disciplined equity investing is a unique and valuable feature.

As long-term readers of this report will know, we follow a four part discipline when it comes to making our equity investments. First we seek profitable businesses with good returns on total capital that don't use too much leverage. Second, we look for management teams with equal measures of talent and integrity. Third, we look for businesses that can reinvest their earnings and compound their value or that practice sound capital management techniques such as good acquisitions, dividends, and share repurchases. Fourth, we seek these attributes at fair and reasonable prices.

You can find the incantation of this four part thought process starting in the 1999 annual report, and we repeat it every year. We were thinking along these lines before 1999 but we just started saying it in the annual report that year and we continue to invoke it as liturgy year after year.

This four part process guides all of our business decisions when it comes to investing in publicly traded equity securities and privately held businesses, as well as personnel and management evaluations and decisions within our existing operations.

We hope you take comfort in seeing the consistency of this approach year after year. We do.

In our fixed income operations we earned a total return of zero percent. Going into 2013 we worried that interest rates were unnaturally low and that the risks of owning longer-term bonds outweighed the returns available from doing so. We worried about that in 2012 and earlier as well.

We knew that we couldn't forecast when interest rates would go up with precision. Therefore, we simply let our fixed income securities mature and we built up our balances of cash and shorter term bonds.

Starting in the second quarter of 2013, interest rates finally did begin to rise. Our total return this year was diminished by the market values of our existing bond holdings falling. The very good news is that we are extremely liquid and now able to reinvest our cash balances at rates which make more sense to us.

We see particular opportunities within the distress of the municipal securities market, and we are gradually beginning the process of investing our liquidity in longer term bonds. Our pace in doing so will depend on our internal cash flows as well as the rate of change in interest rates. As 2014 progresses we expect to structure the portfolio with a longer duration that more closely matches the duration of our claims liabilities going forward.

We normally don't try to predict interest rates but we can use common sense to say that we believed they were too low during the last few years, and now they are trending back to a more normal level. Consequently, we too will trend back towards a more normal bond portfolio over time. This should increase our investment income substantially in the years to come.

Our overall investment return was 6.8% in 2013. We continued to add to our equity portfolio throughout the year as we have done consistently since the low point of equity exposure in the first quarter of 2009. While the addition of the Alterra portfolio on May 1st reduced our percentage of the total portfolio in equities back below 50% of shareholders' equity, we methodically worked to increase that allocation during the year. At year end that ratio stood at 49% and we would expect it to gradually increase towards our more normal target of 80% over time.

## Five - Portfolio per Share

At year end, our investment portfolio per share stood at $1,259 versus $969 a year ago. The Alterra acquisition added $560 per share at closing on May 1st and our investment performance, coupled with the cash flow from operations, allowed us to continue to build our investment balances during the year.

One wonderful attribute of Markel is that over time our insurance businesses produce both underwriting profits and investable funds at the same time. This means that the total investment balances (after subtracting out our debt) produce investment income that accrues to the benefit of the shareholders. In effect, in addition to our own money (the shareholders' equity) which we invest, we get to invest the funds we are holding on behalf of our insurance claimants until such time as the claims come due.

Most businesses just have one pool of funds to invest, namely, shareholders' equity. At Markel, we have two. Our own capital plus the funds we are holding on behalf of others until they are needed. More is better.

## Six - Net Income to Shareholders

Our net income totaled $281 million in 2013 versus $253 million in 2012.

This is the most volatile of the line items in the 20-year table. We understand this volatility and hope that you do as well. At many organizations, volatility causes people to go nuts. Experience has shown they are tempted to tamp it down and pretend that the world is a smooth place. We do not share this delusion.

If we were irrationally afraid of volatility, we could get rid of our equity portfolio, since equities tend to go up and down by greater percentage amounts than bonds. We think that unnaturally attempting to minimize reported volatility would diminish the long-term profitability of the company and work against the interests of long-term owners of the firm compared to short term traders of the stock.

Specifically, if we re-allocated the equity portfolio, we would increase the amount of net income that would flow through the income statement since all of the fixed income interest income gets reported through this line. For equities, only the dividends and realized gains show up as net income. Unrealized gains we earn by holding onto growing businesses do not.

Over time, we've earned hundreds of basis points of higher returns on our equity portfolio compared to our fixed income investments. Much of that excess return shows up only in balance sheet accounts and in comprehensive income. Unrealized gains never go through the income statement. By the way, this is also incredibly tax efficient as we now enjoy a gain of $1.7 billion on our equity portfolio at year end 2013. We've provided for the ultimate tax liability that would be paid should we sell our holdings, but as long as we hold onto those securities we defer paying that tax until the future.

At a 35% tax rate, this means we have over $500 million in our portfolio today, earning a return for our shareholders, which we would not if we chose to invest only in fixed income securities or to sell and realize gains just so they showed up in our net income statement.

We'll trade a little volatility in reported net income for $500 million anytime we can. A little over ten years ago the amount of our deferred tax liability was approximately $50 million. It's accurate to say we accomplished zero in our investment operations for the last decade. Correct! We added a zero. Please root for us to do so again.

### Seven - Shareholders' Equity

Shareholders' equity totaled $6.7 billion at year end 2013 compared to $3.9 billion a year ago. Our shareholders' equity increased $2.3 billion due to our issuance of 4.3 million shares used to partially pay for the Alterra acquisition and our comprehensive income of $459 million offset by $57 million in share repurchases.

### Eight - Book Value per Share

Book value per share reached $477.16 in 2013 compared to $403.85 in 2012. Yeah!

### Nine - Five year CAGR in Book Value per Share

In 2013, the five year compound annual growth rate in book value per share was 17%. We are delighted with this result and we hope that you are as well.

While in the past we have emphasized the book value per share absolute amount, we think it is important to emphasize the five year CAGR percentage just as much if not more than the absolute amount of book value per share. We'll explain why in the next section.

### The Always Treasured Accounting Discussion

Here is the much anticipated accounting discussion. We'll try to make it worth your while to slog through this.

The accounting comments tie to the changing nature of Markel over time. In earlier years we were almost completely, and accurately, described as an insurance company. As such, while the income statement and the cash flow statement were inseparably connected to the balance sheet, the balance sheet stood out as the most important of our three financial statements. From the balance sheet, one can calculate the book value per share, and it would be fair to say that the value of Markel, as well as any other insurance company, shouldn't vary too much from what that book value calculation revealed.

The balance sheet of an insurance company should comprehensively sum up roughly what an insurance company is worth. The assets consist of relatively easy to value items such as cash, publicly traded and market priced fixed income and equity securities, collectible reinsurance amounts, and so on and so on. Similarly, the liabilities should be relatively straightforward and show the future amounts due to policyholders and creditors.

Over time, we've been accorded a premium valuation compared to our raw book value, and compared to most insurance competitors. There were many factors that created our premium valuation in the marketplace, such as a reputation for conservatism in our financial reporting practices, demonstrated customer loyalty as shown by high renewal rates, and excellent long-term financial performance.

We appreciate the vote of confidence the marketplace has provided to Markel, and we will do everything in our power to continue to deserve a premium reputation.

Today, with the ongoing growth of Markel Ventures, the income statement should begin to come more into play as an element of focus for the owners of the company. The value of the Markel Ventures companies stems almost entirely from their ability to produce cash. That ability is not measured predominantly by the balance sheet; it is measured predominantly by current and future income and cash flow statements.

The net income (and associated cash flows) from the Markel Ventures companies comes largely from income statement activities such as selling goods and services for more than the total costs involved in producing them. In some cases, such as at our Weldship and ParkLand operations, the companies are heavy users of capital and need a substantial balance sheet to produce income. By contrast, PartnerMD and RetailData stand at the other end of the spectrum and require only small balance sheets that are dominated by items like working capital for payroll, receivables, and day to day operations.

Fortunately, this spectrum of businesses with various degrees of balance sheet intensity compared to the income statement resolves itself over time with the calculation of the five year CAGR measurement that we emphasize at Markel.

Namely, whatever amount of balance sheet (and associated book value) that the Markel Ventures companies require, it should be relatively consistent over time. The main thing that will change the book value of the various Markel Ventures entities will be the earnings of those companies themselves. The CAGR of the book value of this group should thus serve as a pretty good proxy for understanding how well they are creating economic value for our shareholders.

This calculation is continually refreshed and kept relevant by the passage of time as each year brings a new vintage of returns and a new, yet consistently calculated, base of capital being used to produce those results. The accuracy of this directionally correct surrogate measure should also increase over time as the base of the Markel Ventures business gets larger and more mature.

As our final statement on accounting in this letter think about two different companies where you only knew two pieces of data; the book value per share and the five year CAGR of that book value. At the first company, the book value was $100 per share and the five year CAGR was 8%. At the second company the book value was $100 per share and the five year CAGR was 12%. You would probably accurately conclude that the second company was a better one than the first and worth a higher multiple of book value in the marketplace.  We think that calculation cuts through a lot of accounting details and is valuable information to help you evaluate the company.

This concludes the accounting discussion.

Back to business.

## 2014 and Beyond

2013 was a transformational year for your company. The Alterra acquisition changed the scale and global reach of your company. Every associate in every area of Markel worked to improve your company and translate our new set of opportunities into profitable and durable business.

In addition to the Alterra acquisition, we added Eagle Construction to our Markel Ventures operation. Eagle is a leading homebuilder in central Virginia. We've known the principals at the company for two generations and we had previously partnered with them in a 50/50 joint venture to purchase attractively priced real estate assets in the wake of the 2008/2009 financial crisis.

As evidence of Bryan Kornblau and Bud Ohly's management ability, Eagle remained profitable in 2008 and 2009 despite the myocardial infarction in housing. We are delighted to welcome Eagle into Markel and we think there will be ongoing opportunities to profitably expand this business.

We spent the past year digesting and integrating those acquisitions as well as looking after the basic operations of your company. We invested heavily in our technology platforms and expect to continue to do so in the future.

We served our insurance customers by providing fair and prompt claims services when they experienced losses.

We focused on becoming more valuable suppliers to all of our customers whether they needed insurance, equipment for their businesses, housing, medical services, or other expertise.

We protected the balance sheet of the company through prudent management of credit, interest rate, and equity market risks as we managed the portfolio.

We sought out new companies, new customers and new partners as we sought to build the value of your company.

We changed and improved many processes and expanded geographically.

What didn't and what won't change though is the Markel Style and the values by which your company operates. As the Markel Style states, "We believe in hard work and a zealous pursuit of excellence while keeping a sense of humor. Our creed is honesty and fairness in all our dealings." This value system attracts wonderful associates to this company.

Our decades of doing this consistently show our associates and customers that these are not just words. We mean what we say.

We will continue to do what we say we will.

We are pleased to be able to share this report of long-term financial performance to you as the owners of the company. We are optimistic that we will continue to be able to build one of the world's great businesses and we look forward to reporting our progress in the years to come.

Alan I. Kirshner, *Chairman of the Board and Chief Executive Officer*

Anthony F. Markel, *Vice Chairman*

Steven A. Markel, *Vice Chairman*

F. Michael Crowley, *President and Co-Chief Operating Officer*

Thomas S. Gayner, *President and Chief Investment Officer*

Richard R. Whitt, III, *President and Co-Chief Operating Officer*

# 2014

## To Our Business Partners

Here is our annual report to you for the year 2014. If you are reading this, it's probably because you already own Markel. This is your company. You own it and we work for you. In the course of this report we'll attempt to answer two major questions that we think you would want to know as owners of the business, namely, "How are we doing, and, what's next?"

If for some reason you are reading this and you don't own Markel, we hope that you will want to rectify that void by the time you finish.

*Our goal at Markel is to build one of the world's great companies.* The markers of success in achieving that goal will be outstanding long-term financial results AND an enduring culture that attracts the best associates, customers, and shareholders. We've pursued this dream through three generations of family ownership and over three decades of public ownership and so far…so good.

### Question # 1 – How are we doing?

This was a watershed year for your company. The financial results only hint at the progress made at Markel in multiple dimensions. The people of this company went from a sprint to hyper-speed in adapting to a changing world. We learned important lessons about how to manage and continue to build an enterprise of increasing scale and complexity. First things first, to the associates of Markel, thank you for your amazing efforts.

2014 was a year of great progress, top to bottom. Total revenues grew 19% to $5.1 billion versus $4.3 billion. In our insurance operations, we wrote $4.8 billion of premium volume compared to $3.9 billion a year ago. Most importantly, this was profitable volume with a combined ratio of 95% compared to 97% in 2013. We earned 7.4% on our investment portfolio with equity returns of 18.6% and fixed income returns of 6.5%. In our Markel Ventures operations revenues totaled $838.1 million versus $686.4 million a year ago and we earned Adjusted EBITDA of $95.1 million compared to $83.8 million a year ago.

| *(in millions, except per share data)* | **2014** | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|---|---|---|---|
| Total operating revenues | $ **5,134** | 4,323 | 3,000 | 2,630 | 2,225 | 2,069 | 1,977 | 2,551 | 2,576 |
| Gross written premiums | $ **4,806** | 3,920 | 2,514 | 2,291 | 1,982 | 1,906 | 2,213 | 2,359 | 2,536 |
| Combined ratio | **95%** | 97% | 97% | 102% | 97% | 95% | 99% | 88% | 87% |
| Investment portfolio | $ **18,638** | 17,612 | 9,333 | 8,728 | 8,224 | 7,849 | 6,893 | 7,775 | 7,524 |
| Portfolio per share | **$1,334.89** | 1,259.26 | 969.23 | 907.20 | 846.24 | 799.34 | 702.34 | 780.84 | 752.80 |
| Net income (loss) to shareholders | $ **321** | 281 | 253 | 142 | 267 | 202 | (59) | 406 | 393 |
| Comprehensive income (loss) to shareholders | $ **936** | 460 | 504 | 252 | 431 | 591 | (403) | 337 | 551 |
| Shareholders' equity | $ **7,595** | 6,674 | 3,889 | 3,388 | 3,172 | 2,774 | 2,181 | 2,641 | 2,296 |
| Book value per share | $ **543.96** | 477.16 | 403.85 | 352.10 | 326.36 | 282.55 | 222.20 | 265.26 | 229.78 |
| 5-Year CAGR in book value per share [1] | **14%** | 17% | 9% | 9% | 13% | 11% | 10% | 18% | 16% |

[1] CAGR — compound annual growth rate

In sum, financially, we earned comprehensive income of $935.9 million and the net change in our book value per share was $66.80. There will be many more numbers and tables in the body of this report but suffice it to say that the people of Markel produced outstanding financial results in 2014.

Our associates enjoyed new challenges and opportunities throughout Markel. We expanded in financial size through organic growth and the ongoing successful integration of the Alterra acquisition. We began operating in new territories around the globe, we introduced new insurance offerings, and we added new services and products in our Markel Ventures operations. Associates at Markel should never be bored. There are ongoing opportunities to learn and build at this company. The combination of ongoing personal growth opportunities along with our consistent values as described in the Markel Style, make Markel a wonderful company in which to build a career.

We served our customers. That is why we are in business. During 2014 we provided for our customers with over $1.9 billion of payments for when the earth shook, winds blew, or other unforeseen events, caused covered insured losses. Within Markel Ventures, among other things, we built equipment which our customers used to bake bread, dredge, and haul cars, general cargo, and industrial supplies. We provided affordable housing and medical needs for thousands. We helped retailers with analytics and data they use to run their businesses.

And for our shareholders, the price of each share of Markel rose 18% from $580.35 to $682.84 during the year.

While the short-term annual financial results were great, and the stock price went up, results from any single year do not reliably describe the real accomplishments and progress at your company. It takes longer to make valid judgments.

To begin to correct for this short-term distortion, we as senior managers mechanically use a rolling five-year measurement period to calibrate things like our incentive compensation. The reason we do that is to get a more accurate proxy of measuring our progress in accomplishing the more important long-term goals. We think that time horizon is a bit longer than what most companies use. We also think that orienting ourselves towards long-term thinking offers us a huge advantage. With a long term focus, difficult decisions oftentimes become easier and more obvious.

The answer to the question of, "How we are doing?" also becomes clearer and more accurate when we start to look at five-year measurement terms. In the last five years, revenues grew 148% from $2.1 billion to

| 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | **20-Year CAGR[1]** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ 2,200 | 2,262 | 2,092 | 1,770 | 1,397 | 1,094 | 524 | 426 | 419 | 367 | 344 | 280 | **16%** |
| $ 2401 | 2,518 | 2,572 | 2,218 | 1,774 | 1,132 | 595 | 437 | 423 | 414 | 402 | 349 | **14%** |
| 101% | 96% | 99% | 103% | 124% | 114% | 101% | 98% | 99% | 100% | 99% | 97% | **—** |
| $ 6,588 | 6,317 | 5,350 | 4,314 | 3,591 | 3,136 | 1,625 | 1,483 | 1,410 | 1,142 | 927 | 622 | **19%** |
| $672.34 | 641.49 | 543.31 | 438.79 | 365.70 | 427.79 | 290.69 | 268.49 | 257.51 | 209.20 | 170.95 | 115.45 | **13%** |
| $ 148 | 165 | 123 | 75 | (126) | (28) | 41 | 57 | 50 | 47 | 34 | 19 | **15%** |
| $ 64 | 273 | 222 | 73 | (77) | 82 | (40) | 68 | 92 | 56 | 75 | (10) | **14%** |
| $ 1,705 | 1,657 | 1,382 | 1,159 | 1,085 | 752 | 383 | 425 | 357 | 268 | 213 | 139 | **22%** |
| $174.04 | 168.22 | 140.38 | 117.89 | 110.50 | 102.63 | 68.59 | 77.02 | 65.18 | 49.16 | 39.37 | 25.71 | **16%** |
| 11% | 20% | 13% | 13% | 18% | 21% | 22% | 23% | 26% | 26% | 31% | 17% | **—** |

$5.1 billion. The book value per share rose 93% from $282.55 to $543.96 and we earned comprehensive income of $2.6 billion in the last five years as compared to $1.1 billion in the previous five-year period. If the Beatles meant to write a song about us, "It's getting better all the time" might have been the one they had in mind.

The most robust evidence of success in "How we are doing?" can be seen in the embedded 21 year table of financial results that we include in this report. We encourage you to spend just as much time with the numbers and trends in that table as with the words in this letter. The two are intertwined. The culture, the dreams, the vision, and the tasks we describe in the letter, produce the numbers you see in the table.

We would not have been as successful producing those results without our vision as stated in the Markel Style, AND, our words about culture, and values, and dreams, would ring hollow had we not produced the economic results described in the table. They are one.

### Question # 2 – What's next?

To think about, "What's next?" consider the words of the famous Virginian Patrick Henry when he said, "I know of no way of judging the future but by the past." Much of what we are reporting to you on our recent results came from four distinct decisions during the last few years. We believe in the dictum that "excellence comes from experimentation rather than design." Here are some examples of the experiments/decisions we've made in recent years and how they are influencing current results.

First, several years ago we decided to pursue the "One Markel" initiative. Historically, Markel grew predominantly by acquisition. While we added our culture and incentive systems to the businesses we acquired, we largely left them to operate as they had in the past. Silos of IT systems, marketing channels, relationships, and product decisions, among other items, were largely left in the hands of the managers of the acquired companies. We modestly carried products, people and ideas from one unit to the other, but not massively so. Fortunately, the company grew and we earned wonderful financial results for a long period of time with that general approach.

As always though, the world changed, and we needed to change with it. With the increasing pace of business today as supported by information technology developments, we needed to increase our speed and scalability. The "One Markel" initiative truly changed the mindset of Markel from that of a confederation of individual units into one global company.

In the early 1990's, one knowledgeable investor remarked that they were impressed with Markel, and our creativity and financial performance, but they were concerned that our approach was not scalable. They were right. After several decades of success, we concluded that we were nearing the limits of scalability with our previous approach. So we changed.

It is impossible to overstate the importance of this decision.

It touches everything we do and it is different from our historical approach. That is wonderful. While our values and principles have and will remain unchanged, the tools and specifics needed to successfully operate a business change all the time. We keep what should remain, and we change what needs to be changed. Count on us to continue this effort forever.

Second, the mindset change from One Markel contributed to our decision to purchase Alterra and roughly double the size of the company in one fell swoop.

The thing about doing things in units of "one fell swoop" as opposed to sips, or incrementally, is that it forces you to accept change immediately. Business as usual just doesn't work and you must find a different way to do things.

Ironically, it can often be the hardest to accept change at a successful organization. The mindset of "if it ain't broke, why fix it?" can easily develop when things are going well. The world in 2015 and beyond has no place for that mentality. However things are, they can be better, and the forced reexamination of our business to figure out overnight how to operate a company that was twice its previous size served us well.

We accepted that challenge and we continue to rise to it. The actions we took, and the new mindset, will serve us well into the future.

Third, we decided to integrate the relevant Alterra operations from day one as opposed to simply bolting it on to our existing operations. This was a different approach than our previous insurance acquisitions and a new day-one mindset going into a deal. So far, this approach has worked extremely well. We've had a smoother integration of Alterra than any other previous insurance acquisition at Markel.

The Reinsurance and Global divisions of Alterra were new to us, but those businesses benefited from the increasing scale and value of the Markel brand immediately.

At the same time, we also kept many of our historical practices while integrating Alterra. For example, we strengthened loss reserves for the post acquisition Alterra business to be consistent with our more likely redundant than deficient reserving philosophy even though this approach penalizes the "reported" short-term earnings. We think this approach reinforces and builds our culture of conservatism and ends up producing better real economics over time. We also introduced our longer term and entrepreneurial incentive compensation arrangements to the Alterra associates which have worked so well in reinforcing our culture and producing great financial results for associates and shareholders over long periods at Markel.

Fourth, we pursued the creation and expansion of Markel Ventures.

From the start in 2005 when we purchased 80% of AMF with its roughly $60 million in revenue, Markel Ventures ended 2014 with revenues of $838.1 million and Adjusted EBITDA of $95.1 million. Markel Ventures now stands as a real, and meaningful contributor to the wealth creation underway at Markel Corporation.

Markel Ventures does two things for Markel. One, it gives us another option for capital allocation decisions. Secondly, it makes a bunch of money. As one frame of reference for that statement, consider Markel Corporation 10 short years ago. In 2004, we earned underwriting premiums of just over $2 billion and underwriting profits of $72 million. While the language used to describe underwriting profits from insurance operations, and cash flows from non-financial businesses, are different, it's not that hard to translate. Underwriting earnings are generally comparable to Earnings Before Interest Expense, Taxes, Depreciation, and Amortization. They equal the acronym EBITDA. In 2014, the Adjusted EBITDA of Markel Ventures, which also excludes a non-cash goodwill impairment charge of $13.7 million, totaled $95.1 million. This stuff is starting to add up.

Most companies are limited in how they think about what they can do with capital. They are constrained by several factors. Many need to reinvest in their business just to keep it viable and competitive. We specifically choose to avoid those industries as much as possible. Many see themselves as narrow providers of specific products or services with limited interest, imagination, or desire, to move beyond those realms. We are fueled by imagination and the desire to grow, *and*, we believe it is necessary in a changing world to do so.

Many are constrained by short-term shareholders with little or no confidence in management to make rational and appropriate economic decisions. We continue to do our best to earn the right as managers to make broader decisions with capital than is the current custom in financial markets. We've earned excellent returns on our historical insurance and investment activities, and we've now developed a mature and robust business in

Markel Ventures as well. We hope you are pleased and encouraged with this development. As managers and shareholders ourselves, we are.

This record, and this trust between shareholders and managers, creates the opportunity for us to continue our triage of how we allocate capital.

First, we look to support organic growth in our existing insurance and Markel Ventures operations. We have a team of proven, successful operators within the walls of Markel. Our first choice is to give them more resources when they have the opportunity to put money to work effectively.

Second, we can pursue acquisitions in the realm of insurance or non-insurance businesses (that should cover it). We have experience and a proven track record of being able to successfully acquire and operate businesses all around the world. In the short-term, we can do math and count money. We can, with reasonable precision, know what things cost and what returns we can earn when we own them. We've done that.

More importantly, in the longer term, we see that our *values* and our *culture* work all around the globe. Talented people want to be part of this company. With talented and honest people we can accomplish anything. As such, in the long run we expect the businesses we buy to grow far beyond our initial estimates of size and profitability and to eventually exceed our wildest expectations. We do more of what works, and we give more resources to the talented associates who make good things happen. We do less of what doesn't work, and we reallocate those resources to others.

This works. It is what matters over time.

We ask for an unusual degree of trust and flexibility from our owners and we try our best to be explicit in communicating how we are proceeding with our plan to build one of the world's great businesses. The good news is that you have decades of evidence demonstrating that we deserve this trust and will carry on in building the value of your company. We intend to keep going.

Thirdly, we acquire publicly traded equity and fixed income securities for the dual purposes of supporting our insurance operations and earning good returns on our capital. The great news to report is that our investments did what they are supposed to do. They supported the insurance operations AND they produced excellent returns on our capital.

As to our equity selection process we continue to use our durable four step process in seeking excellent long-term investments. We look for, one, profitable businesses with good returns on capital and modest leverage; two, management teams with equal measures of talent and integrity; three, businesses with reinvestment opportunities and/or capital discipline, at; four, reasonable valuations. You'll find this language in every Markel annual report since 1999. We believed in this approach since the beginning. We just started explicitly stating it in the annual report that year. Expect this language to continue in future annual reports.

As to our fixed income operations, we look for the highest quality fixed income securities that we can find to match up against our insurance liabilities. In large measure, we match the expected duration and currencies of our insurance liabilities to fixed income securities with similar durations and currencies. We do not attempt to forecast or profit from interest rate or currency movements. While we remain humble about our ability to earn returns from forecasting the future, we do remain responsible for protecting our balance sheet against big changes in those factors. As such, we continue to own a portfolio of fixed income securities which mature faster than what we expect from incoming insurance claims. We will continue to maintain this modest override from our normal design until such time as interest rates are higher than current levels. We just don't think we are being paid appropriately to take the risks of owning long-term bonds so we won't do it. It is the same decision any underwriter at Markel would make when they don't think the rewards justify the risk.

We manage practically all of our investments in house at an extraordinarily low cost. At year end the total investment portfolio stood at $18.6 billion. Our total in house management costs remain a single digit number of basis points of that number and can't even be measured until you get to hundredths of a percent. Additionally, we tend to be incredibly tax efficient in managing our investments given our long-term ability to buy and hold quality equity investments. This is a massive addition to the long-term returns you earn as shareholders.

We continue to use our four lenses to find and select investments and we often ignore investment fashions and conventional wisdom while doing so. Currently, two features of today's marketplace strike us as good examples of ways in which we behave differently than most institutions.

One example is the current move to passive and indexed investments. One goal of indexers is to reduce investment costs. Count us in for that part. As we cited earlier, we operate at very low investment management cost levels. The problem with indexing, and when it cycles in and out of favor, is that it is a relatively brainless activity. Certain behaviors and practices get reinforced by money gushing in or out of indexes, and prices of real companies get distorted in the process. We've been around long enough to have witnessed the dreadful returns experienced by indexers in the late 90's and early 2000's. We'll try to use brains and common sense to avoid the excesses of index strategies while at the same time competing toe to toe with them on costs. Our record of now being in our third decade of outperforming the S&P 500 should give you some confidence in our approach.

A second example of how markets periodically become unhinged from long-term reality can be seen in the current action of the oil market. Arguably, oil is the most liquid, important and globally traded commodity on the face of the earth. Hundreds if not thousands of companies participate in the energy business. Hundreds of thousands if not millions of people work in, and study this field. The fact that oil could sell for over $100 per barrel, and for less than half that price within a few short months, should be about all of the evidence you need to dismiss those who believe in efficient markets, or forecasting just about anything.

Our investment record has not and will not be based on our ability to forecast the future of geopolitical changes, interest rates, currency moves, technological change or any other factor that occupies the minds and hours of countless investment professionals. We simply accept that all of those things will continue to fluctuate and change, and that our four part process does the best job we know of finding the people and financial circumstances who will make the best of whatever happens.

Our fourth and final choice for capital allocation happens when we believe that the repurchase of our own shares creates better returns than any of the first three choices. We've only purchased modest amounts of our stock over the years and we believe that you are better served when we can reinvest capital into businesses which create attractive recurring returns.

## The Past – Chapters 1994 to 2014

Financially, our past can be described by the 21 year table that shows our growth in measures such as profitability, net worth, revenues and returns on capital. On all of those measures, we've earned wonderful returns over meaningful periods of time. More importantly, what created those numbers was the leadership, integrity, creativity, flexibility, and adaptability to whatever opportunities came about and in how we responded to changes in economic conditions.

A review of the past, chapter 2014

In our insurance operations we enjoyed a wonderful year in 2014.

By way of a list, here are some of the features from 2014:

1. We made massive progress on the integration of the Alterra operations. Markel operates as a unified company. The process created more scalability and efficiency from our legacy and newer insurance operations.
2. We began a concerted and explicit effort to improve our operational efficiency and discipline to augment our historically strong skills of creativity and relationship building.
3. We systematically created opportunities for our associates to pursue personal development opportunities and transfer knowledge across the organization.
4. We globalized our information technology structure to increase efficiency and increase our opportunity to scale up our business.
5. We developed quick and meaningful actuarial tools that help our underwriters make faster and more accurate decisions.
6. We added analytics capabilities to improve day-to-day decision making regarding catastrophe related exposures, reinsurance market conditions, terrorism issues, and other risk factors.
7. We added new products and exited others that did not meet our profitability requirements.
8. We added internal incentives designed to reward harder to measure front end instances of creativity and ingenuity, in addition to the more traditional incentives associated with back end financial results.
9. We redesigned work flows to increase speed, accuracy and accountability.
10. We amalgamated our claims departments into one global department.
11. We unified our marketing approach to increase the value of the Markel brand.
12. We expanded the very nature of our insurance activities with the ongoing growth of Abbey Protection.
13. And more…

This is just a partial list of activities in our insurance operations. Suffice it to say that we sprinted hard in 2014 as an organization and this is a different and better company than before.

A similar and partial list for Markel Ventures includes the following:

1. We acquired Cottrell. The leading manufacturer of car hauling trailers in the U.S.
2. We added to the size and scale of AMF Bakery systems, now known as the Markel Food Group, with the Tromp acquisitions in the Netherlands.
3. We acquired additional manufactured housing communities at Parkland Ventures.
4. We opened four new offices at PartnerMD.
5. We expanded and deepened strategic customer relationships at RetailData.
6. We demonstrated continuity with successful leadership succession plans.
7. And more…

## The always "treasured" accounting discussion

Feel free to skip ahead here. As Winston Churchill said, "The length of this document defends it well against the risk of it being read." That's okay; the gist of this section tries to communicate two thoughts. The first and most important message, which we discussed last year, is that, in order to understand the financial performance of Markel, it is becoming just as important to focus on our statement of cash flows, and our income statement, as it is on the more historically important balance sheet. We believe that the combination of these statements which over time reconcile to the *relative* measure of *rate of change* in book value per share is equally if not more important than the *absolute* measure of where the book value per share stands at any given point in time. To gain confidence and understanding of that point of view requires diving into the world of accounting.

The second and less important message is that we incurred a minor charge for goodwill impairment within our Markel Ventures operations in 2014. This reduces the reported rate of change in the five-year growth rate of book value per share this year and for the next four years by an amount that doesn't even add up to 1%. After that, it will increase the rate of change in this measurement by a roughly similar amount for the next five years. There is no material economic effect from this adjustment.

We are writing about this because sometimes the rules of accounting seem to describe things in a different way than how we as business people might view something. In 2014 Markel Ventures earned over $95 million of Adjusted EBITDA. Despite that aggregate performance we recorded a $13.7 million goodwill charge to write down a portion of acquisition costs. For all of Markel Ventures, total goodwill on our balance sheet now stands at roughly $216.0 million following this charge.

Making money and taking charges at the same time might strike you as a bit contradictory. That's why we're writing about this. We're trying to give you as much clarity as we can about both the economic conditions of our business as well as about accounting rules so that you can gain insight into how your company is doing. We think it is worth adding some commentary to the raw numbers to give you a clearer picture of how things are going.

Some of our Markel Ventures acquisitions have worked out better than we expected so far, and some have not. Given our heritage and culture of balance sheet conservatism *and* (and the word *and* is really important here) the unit level at which we review entity level balance sheets; we recorded a write-off of the goodwill associated with one unit. We remain optimistic about the long-term economic prospects of that business. We also made the sorts of changes and adaptations that you would expect of us at that unit as well as with each and every other business we manage.

From an accounting perspective, we are required to look at the recoverability of goodwill at the "reporting unit" level and each Markel Ventures affiliate group is a reporting unit for this purpose. If, instead, Markel Ventures was aggregated into one reporting unit, with Adjusted EBITDA of over $95 million compared to a goodwill balance of $216.0 million, it is likely that an impairment charge would not be necessary.

Accounting for goodwill involves multiple layers of judgment, in addition to the cold hard facts. We'll attempt to peel the onion of some of the layers of judgment that frame our goodwill accounting in order to try to help you understand the underlying economic reality at your company. We make every decision with the goal of trying to build the long-term value of your company. That never changes.

Specifically, when we make acquisitions we normally make an accounting entry to establish an initial balance for goodwill. We do this allocation in complete accord with GAAP. While a large amount of judgment is involved in this process, we first allocate purchase price to specific assets and liabilities with easily identifiable market prices and intangible assets that can be amortized. Roughly speaking, whatever amount is left over after those allocations is deemed to be goodwill. To the extent this process results in lower amounts of non-amortizable goodwill, it lowers current income by the amount of amortization of the intangible assets and makes the balance sheet more conservative over time.

In general, when compared to our insurance operations, the Markel Ventures companies tend to have smaller amounts of fixed assets and larger amounts of goodwill as a percentage of the total balance sheet. For non-financial based companies, these facts tend to correlate with the circumstances you would find at a good business. They are markers consistent with a company that produces good cash flows and earnings, and at the same time, doesn't need to make massive capital investments. The value of a business like this tends to come more from cash flows they produce rather than the accumulation of easily marketable asset portfolios.

While accountants appropriately try to make sure that accounting statements provide users with information that helps them understand the underlying economic reality at any given company, it is a tough task to accomplish. Accounting rules change over time. In previous accounting eras, a rough justice approach to goodwill prevailed where the entire amount of goodwill was written off over a number of years. In other eras, different amortization schedules prevailed, and different accounts could be expensed at different rates.

In today's world, accountants mandate that the goodwill amounts on a balance sheet must be constantly evaluated and reviewed. Many billable hours are consumed in this process. This is a one-way process where goodwill might be currently perceived as impaired and therefore charges are taken. If subsequent circumstances improve, the goodwill that was written off in previous periods will never be restored and written back up.

In another instance of making money and taking charges at the same time, consider the "Other-Than-Temporary Impairment" accounting treatment that applies to our portfolio of publicly traded securities. While our overall equity portfolio earned 18.6% in percentage terms and $611.0 million in dollars, we charged $4.5 million against our net income for certain lots within that overall portfolio that were deemed by accounting policies to be "other-than-temporarily impaired." If those securities rise in market price in subsequent periods they will not be written up. The gains will only show up in the income statement when they get sold. This is a small amount relative to the balances involved, but it illustrates how items can travel around between income statements and balance sheets in a way that can be confusing. Fortunately, the net change in book value calculation that you can perform by using the balance sheet rather than the income statement corrects for this effect.

As we wrote last year, historically Markel Corporation was largely and accurately described as an insurance company. As an insurance company, the balance sheet towered over the income statement and the statement of cash flows as the most important of the three financial statements. We always embraced a culture of conservatism and did our best to make sure that balance sheet was as conservatively stated as possible.

Nothing about that has or will change.

The good news remains that in our view the most important single financial metric of *net change in book value per share* will still do an excellent job of accurately describing the economic progress we are making at your company.

To give you some degree of understanding as to why we're so focused on the compound annual growth rate (CAGR) in book value per share, consider the following. For the last five years, the CAGR in book value per share was 14%. For the same five years, the CAGR of the Markel Stock price was 15%. For the 21 years listed in the table, the CAGR in book value per share was 16%. The 21 year CAGR for the stock price was 15%.

It is no accident that those numbers are so similar. If you want to have an idea of what you'll earn in the future from owning Markel, our estimate stops and starts with the *rate* at which the long-term CAGR of book value per share grows. The long-term *rate* of increase in that number is the least worst proxy to determine how we are doing as managers in building the value of your company.

We try to make the growth in book value per share as high as it can be in each and every aspect of our insurance, investing, Markel Ventures, and capital allocation decisions.

**Final note**- If it is of any comfort to you as readers, five out of the six people signing this letter wished that we didn't write about accounting. But as Bono of U2 sings in One Love, "We get to carry each other." The sixth member of the band looks forward to not writing about accounting as well, but feels that it is of mortal importance to understand the nuances and challenges involved in translating between GAAP accounting procedures and economic reality.

## The Future – 2015 and beyond

In all of these activities throughout the entirety of the Markel Corporation we continued our long-term path of building one of the world's great companies.

Our simple forecast for "What's next?" is *more of the same*. We will continue to come to work every day. We will think creatively about how to operate our business more efficiently and effectively, we will think about what businesses we should pursue and what we should cede to others, we will try to attract and retain the most talented people we can find who share our values, and bring increasing skills and talents to the company. We will dedicate ourselves to learning continuously, and we will never stop. While "getting better all the time" is a pleasant tune when you hear the Beatles sing it, the reality is that it describes an eternally challenging, but magnificent, quest.

This is not a new statement in 2014. It's what we've done continuously at Markel since Sam Markel started this company with an idea in 1930.

We are not done. We enjoy the process of getting better and we will continue to work at that task. As such, the next chapter for us is more of the same…*more*.

Thank you again for your confidence and trust in us as managers of your company. We look forward to reporting to you on our ongoing progress and we deeply appreciate the opportunity to build this institution and what it represents.

Alan I. Kirshner, *Chairman of the Board and Chief Executive Officer*

Anthony F. Markel, *Vice Chairman*

Steven A. Markel, *Vice Chairman*

F. Michael Crowley, *President and Co-Chief Operating Officer*

Thomas S. Gayner, *President and Chief Investment Officer*

Richard R. Whitt, III, *President and Co-Chief Operating Officer*

OMAHA, May 3 -- On the weekend of the Berkshire Hathaway 50th anniversary gala that drew visitors from all over the world, Markel Corp. celebrated the 25th anniversary of its morning-after brunch much more quietly. There was no movie. Tom Gayner didn't offer to fight Floyd Mayweather, or even Manny Pacquiao, although he did have some very nice things to say about former Lakers power forward Kurt Rambis.

Also, your humble correspondent got up the nerve to go to the mike and ask the questions he complained were not asked at the 24th brunch a year ago, as you may or may not recall. He also got a chance to follow up with Gayner after the brunch, all of which we will get to in due course. But let's start at the beginning.

The contingent of Markel executives at the head table was double the size of last year's, partly by accident and partly by design. There were supposed to be three last year, but Richie Whitt, the president and co-COO, had a conflict, so there were only two: vice chairman Steve Markel and president and chief investment officer Tom Gayner. Whitt made it this year and they also added Anne Waleski to the mix. She's vice president and chief financial officer. To meet Alan Kirshner, the CEO, you have to go to the annual meeting in Richmond (next week) because he's "the most camera-shy CEO," according to Whitt.

Recalling the origins of the Omaha meeting, Gayner said the thinking was, "The people who are most likely to understand what we're trying to do are people who already own Berkshire." The brunch meeting, Gayner said, is "the only investor presentation we do all year."

Markel followed by thanking the several hundred people who filled the main Hilton ballroom for making a special trip to Omaha to hear them and hoped we all found something to occupy our time on Saturday. He also offered the baseline history: Markel was founded by Sam Markel as a small insurance agency in 1930. Steve joined in 1975. The company went public in 1986, raising about $5 million in an initial public offering. It was still a very small enterprise at that point with a market cap of $30-$35 million. Today the market cap is $10.4 billion, "so we've come a long way."

"We're really just getting started," Markel said. "The opportunities for us in the world of insurance and the world of other businesses is really unlimited."

In a tradition I explained in last year's post, money manager and sometimes-activist-investor David Winters asked the first question. Picking up on introductory remarks by Markel about the "Markel style," which he said "defines how we do business," Winters wanted to know what specific characteristics comprise it.

Gayner said it's a value system and a system of brain wiring. It is a "geometric challenge" to maintain it as the organization grows, he said, but after a while "it's almost like the organism rejects someone" when they aren't in sync with Markel's values.

Markel was more specific. He said people who fit with the Markel style value teamwork over individual achievement; have a disdain for bureaucracy and bureaucratic processes; believe in the primacy of serving shareholders; and prefer a meritocracy to a general sort of egalitarianism.

"If someone is more focused on net income than net worth," he or she is probably not a fit. A person who cashes stock options after two years to buy a boat would be less likely to fit that someone who still held them 10 years later.

The next question was about CarMax, which allowed Gayner to praise its fixed-price model, an innovation in the used car business. Another questioner later would point out that Warren Buffett and Charlie Munger both opined the day before that people really seem to like negotiating when they buy big-ticket items like houses and cars and they didn't see much chance of that changing. To that later question, Gayner replied:

"It's a big world. There's room for both models . . . Some people like it and some people don't and it's a big enough world for both."

The first CarMax question included a characterization that it was Markel's biggest position. Gayner said it shows up that way on many lists because Markel's Berkshire position is bifurcated into A and B shares, but when you combine them, Berkshire is its biggest position.

This is not what dataroma shows as of year-end 2014, when it reported a 75 percent reduction in Berkshire A shares, leaving a combined allocation to Berkshire of about 7.6 percent, compared to 8.7 for CarMax, but Gayner ought to know. I have not looked at the most recent filings to resolve this, but suffice it to say they are Markel's two largest equity positions, adding up to about 16 percent of the stock portfolio a of the last dataroma report.

The next question came from a woman who said she was glad to see Waleski on the podium, but looking at the corporate officers, they seemed very white and very male and she wondered about encouragement of diversity.

"Well, speaking personally, I'm pretty much stuck as a white male," Gayner said.

Waleski said she was glad Gayner hadn't mentioned gender when he introduced her as an addition to the front table because Markel's "environment is you get rewarded for hard work regardless of ethnicity."

Gayner said statistically women make up a large portion of No. 1 and No. 2 executives within Markel Ventures and he mentioned Kirshner's "partnership for the future" program, which mentors minority high school students in the Richmond area.

There was a question about alternative sources of capital moving into the reinsurance business, taking off from a discussion by Buffett and Munger about reinsurance being used as a "beard for asset management" by hedge funds. Both said it was not as attractive a business as it used to be as a result.

The Markel people seemed much less worried about this, although they acknowledged it's an issue at the moment. The complaint is that hedge funds aren't as concerned with profitable underwriting because they basically value it as a cover for their asset management business. Markel pointed out that if this new capital generates negative or substandard returns, it will stop being so popular. He suggested "a major event," insurance-speak for a disaster, natural or otherwise, will cull the herd. "If we're right, they'll make substandard returns and disappear," he said.

Whitt put this more succinctly:

"One thing I've noticed: It appears God hates cheap reinsurance. He punishes it relentlessly."

Because reinsurance is 20 percent of Markel's business, the company has the flexibility to turn down business when it's priced poorly, as opposed to a 100 percent reinsurance business, which has no choice about participating in the market.

"We've got a 360-degree view of the best thing to do with money," Gayner said. "Reinsurance is not inherently a good business or a bad business. It's a tool. If it's not all you do, you can use it as appropriate."

Someone asked them to name the greatest threat to their business.

Markel started by saying, "I feel awfully good about our business," and it's a challenge to think of one big danger. In fact, he said, this may be the biggest danger. And then he used a word that wouldn't get by the Motley Fool profanity censor the last time I checked, so I'm going to do the dash thing: "We don't want to believe our own b---s--- all the time."

Waleski mentioned liquidity. She said they're in good shape and very conservative, but as CFO she is paid to worry about "a major event" combined with "a market event," which would be insurance-speak for a disaster, natural or man-made, and market crash at the same time.

Gayner mentioned monitoring the sorts of mistakes the company makes. "As Alan Kirshner says, it's OK to make mistakes at Markel, just don't keep making the same dumb-ass mistakes." He also said complacency can make you so happy with what you're doing that it's easy to say no to new risks and new things, which stifles innovation. "The success that breeds complacency is an extremely dangerous thing." He mentioned three people who don't mind telling him when he's wrong, among them Steve Markel and his wife, Susan, a chemical engineer by training who works for Markel as well. Gayner admitted he "can be a little thin-skinned" when Markel tells him he's making a mistake, but Markel has the useful trait of being critical when things are going well and supportive during the tough times.

There was a question about Fairfax India, a $1 billion fund to which Markel contributed $40 million poised to make investments in India. Markel said they like the prospects in India, but it's a relatively small investment.

An 8-year-old asked for advice. "I would say listen to your dad," Gayner said.

A mike was open so I took it and asked Gayner to provide some insight into the way his brain works as an equity investor. I pointed to several specific areas: his investment in Amazon, the poster child for mockery by value investors; his long-held position in Brookfield Asset Management, which has been criticized for its accounting; a larger number of equity positions (over 100) than Berkshire with a much smaller amount of money involved. And I asked him to clarify the percentage of investments devoted to equities.

It's hard to take notes and make eye contact with someone trying to answer your question at the same time, so most of this is paraphrased, but it just happened, so I'm still pretty clear on it, I think. I'm no accountant, so anybody else who was there should feel free to correct me if necessary.

First, he went into the percentage devoted to equities because I'd mentioned at least three percentages that represented different things or conditions. I'd mentioned 80 percent, the number he cited before the Alterra acquisition; 40 percent, the number he mentioned after the Alterra acquisition, and 22 percent, the number mentioned in the annual report.

The 22, he said, is the percentage of total investments, which includes collateralized insurance reserves and other things that would not be considered part of the investible portfolio. The 80 was the pre-Alterra high and remains the long-run target for the investment portfolio. The 40 included not only dilution of the equity portion from acquiring the Alterra fixed-income portfolio, but also losses in equity positions as a result of the market crash of 2008-09. Currently the correct number is in the "mid- to high-50s," and stay tuned next week for the specific number when they report first quarter results.

He combined his answers to the Amazon and number of positions questions. The top 20 positions in the portfolio represent 70 percent of the value, he pointed out. "It's almost like a baseball organization," he said. Those top 20 names are the major league roster. The rest are the farm system, going from Class AAA to Class AA to Class A to Rookie League as the allocations decline.

He bought Amazon, he said, because "this is an important company" with which a very large percentage of Americans interact in some way. He bought it "to make myself think more deeply about it. I think more about a company if I own it than if I don't own it."

He doesn't exactly think of each company as its own distinct position. For example, he owns four companies that sell alcoholic beverages. "Is that four positions or one?" he asked. "Neither. Is it 1 1/2, 2 1/2?" He encouraged me to look at investments in similar companies, or companies in similar circumstances, collectively, or piled on top of one another.

On Brookfield, I had asked whether, as an accountant, he goes into the weeds on all the related-party transactions and other accounting maneuvers that have drawn criticism, or if he simply trusts Brookfield management since he knows them.

"I do know and trust those people," he said. When Steve Markel needed financing for some Markel project, it was a Brookfield sub that provided it, he said. And then Gayner harkened back to his answer on reinsurance about the virtues of a 360-degree view that doesn't tie you to any particular investment universe if it happens not to be a good deal at that time.

"The No. 1 reason I like Brookfield is they come to work looking at the whole world," he said.

The brunch meeting starts at 10 -- actually 9:55 this year -- and ends at noon so that investors and shareholders in town for the Berkshire meeting can make their flights home. But Gayner and the others stick around and speak with smaller groups for a bit afterward. So I joined the after-meeting scrum around Gayner and got a chance to follow up.

I asked him when he buys and then sells Amazon, as he did a couple of years ago, if that reflects a change in his thinking, a change in the company's performance, or something else. He said in that particular case it may have been that he bought it at 250 and watched it go to 500 and decided to take the cash because he really hasn't figured out the company yet and so doesn't know if he wants to own more of it or less of it.

So I asked him more generally when he invests in an Amazon or a Google, which Markel owns in a small position, how he evaluates such growth names from a value sensibility. He said a lot of what makes Amazon look so unattractive to traditional value investors is just accounting. If all the money it spends to build its brand was instead spent on plant and equipment, it would be depreciated over time, allowing more of its revenue to fall to the bottom line. Amazon expenses it all immediately, making it look worse from a profitability standpoint. He was clearly simplifying for a non-accountant, and said as much, but he suggested that he sometimes translates the accounting into a more traditional form in order to project cash and earnings going forward.

So anyway . . . it was satisfying to get him to address these things and I feel I have a better understanding of the way he thinks about them. He did tell me not to be surprised if Amazon shows up on Markel's holdings list again, but he admitted again that he just hasn't figured them out yet.

When I resumed taking notes following the public portion of my exchange with Gayner, Steve Markel was being asked about Germany, much as Buffett and Munger were the day before. He noted that Markel has been an international company for only 10 years, so it has a lot to do to earn the sort of global reputation it has earned as a national company.

Gayner picked up on the idea of reputation, quoting a commercial real estate agent in Chicago who told him, "I don't remember everybody who paid me, but I guarantee I remember everybody who didn't."

"The best way to be trusted is to is to trust, to extend that," Gayner said. "Either it's reciprocated or it isn't and you move on."

There was a question about insurance in Florida, which allowed Steve Markel to explain the strange dynamics of hurricane country. If a fair rate is 100, he said, picking a round number out of the air, it will drop every year there is no major event. So, if you have a number of years without a big hurricane, as Florida has recently, the rate will drop as low as 50 or 40, which is not nearly enough to account for the actual risk. Immediately after a big hurricane, on the other hand, the rate will spike to maybe 120. "That's the place to write business," Markel said.

Gayner told the story of a turkey that is given food and water by its owner every day. Based on this treatment, the turkey decides the owner must love him. Gayner told the story from the view of the turkey. "He loves me!" Then, on Thanksgiving Day, the owner comes out and breaks its neck. "He didn't love me!"

As it applies to the insurance pricing dynamic Markel had just described, Gayner said the question for Markel is, "Are we the turkey here?"

There was a question about cyber security insurance in which the questioner rattled off all the parts of his business that Markel insures, then mistakenly called it Fairfax, damaging his attempt to curry favor. In any event, Whitt said fear of cyber attack is high and Markel gets a lot of inquiries about cyber security insurance, but has a hard time closing sales. "The area is still developing," he said. Whitt mentioned that hackers seem a step ahead of security and law enforcement, so it's dangerous. I'm guessing that also makes the insurance pricey, which may be why it's hard to close sales since it would be a new expense for many firms.

There was a question related to the discussion at the Berkshire meeting about 3G Capital, in which a shareholder criticized Berkshire's association with the private equity firm and Buffett and Munger defended it. Gayner basically repeated Buffett's and Munger's argument. "No business can stay in business . . . without earning some appropriate returns on capital. There's nothing untoward or unholy about that."

Markel differed slightly. "I happen to agree that the approach that Berkshire has with 3G is different from the approach they had" before, he said. In any case, Markel does not have the skill set to go into major reorganizations. "We won't be buying businesses that are distressed and need to be fixed," Markel said.

Gayner pushed back a little, pointing out that it's hard to find businesses that have no problems selling for reasonable prices, especially with the market awash in private equity. "As we gain skills and talents, we may indeed consider opportunities where we need to be more operational than we've been," he said.

So somebody else followed up by asking if Markel might partner with a 3G-like firm that had operational expertise. This produced one of Gayner's less transparent analogies. He asked how many people in the room had heard of Rambis, the least glamorous of the '80s Lakers who did the dirty work on the boards and let Magic Johnson and the crew do their Showtime thing. Gayner called him "my favorite NBA player of all time" and "a spectacular rebounder" who knew what his role was and hung around the boards to do it.

Berkshire, Gayner said, got the opportunities it got during the financial crisis, as well as the opportunities presented by 3G, because it was "hanging around the boards." People knew what it could do and found it when they needed it. This led to a downright philosophical observation about how much time it took Buffett to make the Bank of America deal.

"Either he made it in a minute or he made it in a lifetime," he said.

Someone from Venezuela asked about opportunities in Latin America. Nobody took the opportunity to make a joke about his home country, which I'm not sure Munger would have resisted. Whitt said Markel has relatively small Latin American operations at the moment. "It's incredibly competitive in Latin America right now," he said. Everybody wants in, so pricing isn't great. Steve Markel agreed, saying the company would like to do a lot more there, but margins are "skinny" at present.

Another investor allowed his child to ask a question. The boy asked what Markel's goal is.

"We want Markel to be one of the world's great companies," Gayner said. "It's a big dream."

With that, he thanked everybody for coming. Seemed like a good note to end on.

# 2015

## To Our Business Partners

Here is our annual report for 2015, our 30th as a public company. Each and every year we provide you with an update on our recent financial results as well as our plans for the future. We're pleased to report another year of progress in building your company. As we said in the very first report, "we focus on customer needs and solving customer problems." That remains the case today. We just do it for many more people, in many more locations, with many more products and services.

In this report we will update you on our 2015 financial results and then tackle two questions facing us for 2016 and beyond, namely, "What is changing at Markel, and what remains the same?"

At Markel, as well as throughout all businesses, the pace of change continues to accelerate. As such, we continue to refocus our initiatives and actions to adapt and evolve appropriately to the changing business environment. With our longstanding commitment to continuous learning, we embrace the new tools of technology and analytic disciplines, to refine and improve our decisions. We are increasing speed and ease of use for our customers, and we are lowering the expense associated with doing so.

We also continue to enjoy a profound advantage in that we have one feature which remains the same despite the changing business landscape, namely our culture. Prior to Markel's public offering in 1986, we wrote the words of the "Markel Style" in an attempt to define and explain our culture. You will find the Style on the inside cover of this report, and on many plaques, documents, mementos, and items around the many locations where we operate. More importantly, you will find the spirit of the Markel Style embedded within the people of this organization.

### FINANCIAL HIGHLIGHTS

| *(in millions, except per share data)* | **2015** | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|---|---|---|
| Total operating revenues | $ **5,370** | 5,134 | 4,323 | 3,000 | 2,630 | 2,225 | 2,069 | 1,977 | 2,551 |
| Gross written premiums | $ **4,633** | 4,806 | 3,920 | 2,514 | 2,291 | 1,982 | 1,906 | 2,213 | 2,359 |
| Combined ratio | **89**% | 95% | 97% | 97% | 102% | 97% | 95% | 99% | 88% |
| Investment portfolio | $ **18,181** | 18,638 | 17,612 | 9,333 | 8,728 | 8,224 | 7,849 | 6,893 | 7,775 |
| Portfolio per share | **$1,302.48** | 1,334.89 | 1,259.26 | 969.23 | 907.20 | 846.24 | 799.34 | 702.34 | 780.84 |
| Net income (loss) to shareholders | $ **583** | 321 | 281 | 253 | 142 | 267 | 202 | (59) | 406 |
| Comprehensive income (loss) to shareholders | $ **233** | 936 | 459 | 504 | 252 | 431 | 591 | (403) | 337 |
| Shareholders' equity | $ **7,834** | 7,595 | 6,674 | 3,889 | 3,388 | 3,172 | 2,774 | 2,181 | 2,641 |
| Book value per share | $ **561.23** | 543.96 | 477.16 | 403.85 | 352.10 | 326.36 | 282.55 | 222.20 | 265.26 |
| 5-Year CAGR in book value per share [1] | **11**% | 14% | 17% | 9% | 9% | 13% | 11% | 10% | 18% |

[1] CAGR — compound annual growth rate

We believe our culture as described in the Markel Style is timeless. Among other items, the Markel Style speaks of, "a commitment to success, hard work, a zealous pursuit of excellence, honesty, a sense of humor, quality" and other eternally valuable attributes. We believe that the principles described in the Markel Style will continue to reliably guide our decisions in 2016 and beyond just as they have in the past.

As always, all of the financial results and every single initiative that we discuss in this letter come from the skills, dedication, and hard work of the people of Markel. We thank our colleagues for their efforts, and we look forward to increased mutual success in 2016 and beyond. Thank you.

## 2015 Financial Results

To start, here are the headlines for 2015. We produced total revenues of $5.4 billion and comprehensive income of $232.7 million. The 5 Year Compound Annual Growth in Book Value per share was 11%.

In our insurance operations, gross written premiums declined to $4.6 billion in 2015 from $4.8 billion in 2014. While overall volumes declined, we earned record underwriting profits of $429.7 million in 2015 compared to $177.6 million in 2014 with a combined ratio for 2015 of 89% compared to 95% for 2014.

In our investment operations, we earned net investment income from interest and dividends of $353.2 million during 2015 compared to $363.2 million during 2014. We realized gains of $106.5 million in 2015 compared to $46.0 million in 2014. The change in unrealized gains in 2015 was ($457.6) million compared to $981.0 million in 2014. In total, investments produced a negative total return of (0.7%) compared to 7.4% a year ago.

In our Markel Ventures operations, revenues totaled $1.0 billion for 2015 compared to $838.1 million for 2014 and EBITDA for the year totaled $91.3 million compared to $81.3 million the year before.

We will expand our discussion of each of these factors through the course of the report.

| 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | **20-Year CAGR[1]** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ 2,576 | 2,200 | 2,262 | 2,092 | 1,770 | 1,397 | 1,094 | 524 | 426 | 419 | 367 | 344 | **15%** |
| $ 2,536 | 2,401 | 2,518 | 2,572 | 2,218 | 1,774 | 1,132 | 595 | 437 | 423 | 414 | 402 | **13%** |
| 87% | 101% | 96% | 99% | 103% | 124% | 114% | 101% | 98% | 99% | 100% | 99% | **—** |
| $ 7,524 | 6,588 | 6,317 | 5,350 | 4,314 | 3,591 | 3,136 | 1,625 | 1,483 | 1,410 | 1,142 | 927 | **16%** |
| $752.80 | 672.34 | 641.49 | 543.31 | 438.79 | 365.70 | 427.79 | 290.69 | 268.49 | 257.51 | 209.20 | 170.95 | **11%** |
| $ 393 | 148 | 165 | 123 | 75 | (126) | (28) | 41 | 57 | 50 | 47 | 34 | **15%** |
| | | | | | | | | | | | | |
| $ 551 | 64 | 273 | 222 | 73 | (77) | 82 | (40) | 68 | 92 | 56 | 75 | **6%** |
| $ 2,296 | 1,705 | 1,657 | 1,382 | 1,159 | 1,085 | 752 | 383 | 425 | 357 | 268 | 213 | **20%** |
| $229.78 | 174.04 | 168.22 | 140.38 | 117.89 | 110.50 | 102.63 | 68.59 | 77.02 | 65.18 | 49.16 | 39.37 | **14%** |
| | | | | | | | | | | | | |
| 16% | 11% | 20% | 13% | 13% | 18% | 21% | 22% | 23% | 26% | 26% | 31% | **—** |

As always, we include a 21 year recap of the financial results for your company in the table that accompanies this letter. Over time, this table illustrates a wonderful record of financial progress. As you examine the chart year by year, you can see that this record of multi-decade progress did not happen in a straight line. Some years were better than others. 2015, like many other years, contained both solid accomplishments and real challenges. We are familiar with that outcome and we remain optimistic about our ability to build on this wonderful long-term record.

## 2015 Insurance Operations

In 2015 we wrote $4.6 billion compared to $4.8 billion in 2014. As we've reported in previous years, the insurance market remains marked by intense competition. Despite that, we posted a combined ratio of 89%, our best underwriting ratio performance since 2007. Each and every division within our insurance operations produced an underwriting profit.

Our profitability this year benefitted from our longstanding practice of disciplined underwriting. We also enjoyed the good fortune of no major catastrophes.

In our U.S. Insurance segment we produced gross written premiums of $2.5 billion in both 2014 and 2015. However our combined ratio was an 89% this year compared to a 95% last year. This improved profitability is an outgrowth of our ongoing intense effort on the fundamentals of managing the disciplines of underwriting, marketing, claims and administration. Despite competitive overall conditions in the marketplace, all three divisions included in the U.S. Insurance segment contributed to this improved performance.

In our Markel Specialty division, led by Matt Parker, we wrote record premium volume and produced a better combined ratio than in 2014. During the year we unified the leadership across all departments within our specialty operations. The divison's record premium volume and improved profitability reflect our multi-year efforts to increase the consistency of our underwriting, marketing, and operational efforts.

Our Markel Wholesale division, led by Bryan Sanders, also performed admirably in challenging market circumstances. Excess and surplus offerings tend to experience the greatest changes in overall volumes as they respond to different insurance market environments.

As always, we focus on people, products, technology, and relationships. We work diligently through each of these dimensions to serve our key producers and clients. We continue to increase the ease and speed of quoting, binding, and transacting with Markel, and we expect to do so again in 2016 and beyond. We also continued to improve our internal efficiencies as marked by improvements in our expense ratio.

In our International Insurance segment, premium volume decreased slightly year over year due to competitive market conditions, however, as a result of our disciplined underwriting approach, we produced an 86% combined ratio in 2015 compared to a 93% in 2014 with improved results from both the Markel International division and the Global Insurance division.

Other 2015 accomplishments from our Markel International division, led by William Stovin, include successful efforts to meet the new Solvency II regulatory requirements. This is a major accomplishment. Markel was among the first UK companies to gain this approval and it speaks to our internal control processes and respectful relationships with our regulators.

The Markel International division also continued to methodically develop opportunities in new locations. For example, we opened an office in Dubai during 2015. We also continue to see opportunities everywhere around the globe and we now have offices in Asia, Canada, Europe, North and South America, and Bermuda. Additionally, the Abbey Protection legal and professional services operation of Markel International that we acquired in 2014 continues to meet our expectations.

Our Global Insurance division, led by Britt Glisson, also faces highly competitive market conditions. Despite those headwinds, Britt and his team productively refined and focused their operation during the year. These efforts, along with the combination of lower catastrophe losses, exiting some previously unprofitable lines, and favorable development of prior year reserves, drove a big swing in the profitability.

The Reinsurance segment produced $965.4 million of gross premium volume in 2015 compared to $1.1 billion in 2014 and delivered a 90% combined ratio this year compared to a 96% combined ratio last year.

Our Global Reinsurance division, led by Jed Rhoads, continues to confront one of the most competitive aspects of the insurance marketplace. However, we maintained our unwavering discipline of underwriting profitability regardless of market conditions. We enjoy longstanding relationships with our reinsurance customers and they value our consistency and dependability.

Finally, we undertook a comprehensive review and consolidation of our claims operations in 2015. Under the leadership of Nick Conca, Hannah Purves, Mike Clancy and Alex Sardinia, we began to consolidate our claims processes to improve efficiencies in our claims handling for the benefit of our customers while reducing costs.

This effort marks a continuation of several multi-year initiatives that began in our underwriting divisions. Over the years, Markel acquired several insurance companies with distinct underwriting, marketing, sales, IT, and claims systems. Beginning with the One Markel initiative that was started in 2009 and continuing with the Alterra acquisition, we continue to unify these functions across the entirety of Markel.

In 2015, we increased the focus on the claims aspect of this effort and we are pleased with the outcome so far to streamline and improve upon our claims processes. The goal from this initiative, as is the case with every other effort at Markel, is to serve our customers in better and more efficient ways.

## 2015 Investment Operations

Overall investment market conditions remained dominated by low levels of interest rates and low overall returns worldwide during 2015. Markel's overall investment portfolio produced a positive return of 0.5% in local currency terms with equities down 2.5% and fixed income up 1.6%. Weakness in foreign currencies versus the U.S. dollar reduced returns by (1.2%) to produce a net return of (0.7%).

In the face of these conditions we made several key decisions during the year.

First, we maintained our focus on the quality and strength of our balance sheet. Do not expect this to change. In 2015 that meant that we gradually built liquidity during the year with higher cash balances, the highest credit quality fixed income portfolio that we can assemble, and slightly lower holdings of equity securities as a percentage of total capital. We did all this, and at the same time worked to more closely match both the duration and currency profiles of our fixed income holdings to our insurance liabilities. We also worked to maximize the returns from our holdings by minimizing the costs of trading, taxes and management. This has been and continues to be a longstanding and unwavering effort.

Over many years we've discussed our process of selecting equity investments. To review, we follow a four part process of seeking profitable businesses with good returns on capital at modest leverage, with honest and talented managers, with reinvestment opportunities and capital discipline, at fair prices. Long-term readers of this report will recognize that this has been the case for decades.

As we followed this bottom up approach during the year we sold several longstanding holdings. We became concerned that the changing landscape of competitive conditions diminished our expectation for fundamental levels of profitability. As we elected to exit these holdings, we reinvested the proceeds at a slower rate. The combination of these factors increased our liquidity and conservatism of our balance sheet in 2015.

We continue to engage in our search for equity securities which meet our four part test and we fully expect to increase the percentage of equities in our portfolio in the future. We will remain patient as we search for specific opportunities to do so.

Fortunately, we've got good news to report on our fixed income portfolio. For many years, we've consistently taken every opportunity to invest in the highest quality government and municipal securities that we could find. We allowed our historical portfolio of corporate bonds to mature over time, and we also let the credit exposures we inherited through acquisitions diminish through normal maturities. These decisions to increase the credit quality of the portfolio served us well in 2015.

For the last several years we also operated with a shorter overall duration of the fixed income portfolio compared to the duration of our insurance liabilities. We did this to protect our balance sheet against the risk of higher interest rates.

Going forward, we will continue to maintain and build upon our high credit quality profile. During 2015 we also started the process of getting back to a more normal matching of duration between our insurance liabilities and our fixed income portfolio. We expect to maintain a more closely matched position going forward.

## 2015 Markel Ventures Operations

In 2015, we posted revenues of $1.0 billion compared to $838.1 million in the previous year. EBITDA totaled $91.3 million in 2015 compared to $81.3 million in 2014. As was the case in 2014, the reported EBITDA included several items which we believe would be useful to highlight in order to increase understanding.

Specifically, in 2014 EBITDA from Markel Ventures totaled $81.3 million after a write-off of goodwill of $13.7 million. As we've written in the past, each acquisition within Markel Ventures stands as a separate reporting unit and we evaluate goodwill for each unit rather than in aggregate. Unfortunately, we did not experience the improvement we expected in 2015 in our Diamond Healthcare unit and we wrote off the remaining goodwill from that acquisition of $14.9 million. Make no mistake; this has been a challenging acquisition and we've now fully written off all associated goodwill.

At the same time, we've enjoyed wonderful and better than expected results from our acquisition of Cottrell. As is often the case, that acquisition included an earn-out provision calculated over a multi-year period. Under current accounting treatments, that earn-out in excess of our original expectations was treated as a period expense for the 2015 income statement as opposed to being included in the capital accounts of the balance sheet. The earn-out increase caused by the better than expected results at Cottrell totaled $31.2 million.

Ironically, the bad news at Diamond and the good news at Cottrell both got reported in the same way, as deductions from EBITDA in 2015. Those items which totaled $46.1 million will not repeat themselves in 2016 and beyond. The goodwill balance at Diamond now stands at zero, and the earn-out period at Cottrell is complete.

In aggregate, we are pleased with the overall progress and economics from our Markel Ventures holdings. We've enjoyed several years of profitable results from the majority of the Ventures companies. We've also learned some painful lessons along the way that should help us with future capital allocation and management decisions.

Finally, at year-end, we announced the acquisition of a majority interest in CapTech, a management consulting firm based in Richmond, Virginia that helps to bridge the gap between business and technology. We've known Sandy Williamson and Slaughter Fitz-Hugh, the founders of CapTech, for many years, as well as many of the associates of the firm and the quality of their work.

For the last two years, overall market conditions made it tough for us to continue to expand our operations through acquisitions. Fortunately, in the case of CapTech, the founders knew us well, and valued our culture. They knew we valued in words and deeds the efforts of creative individuals working hard to solve problems for their clients and building a good business while doing so. As such, we mutually agreed upon a majority investment by Markel. These negotiations took place principal to principal.

CapTech assists a roster of successful businesses with selecting and implementing the never ending flow of new technological systems and processes. In addition to providing a permanent platform for CapTech to continue to serve their clients and to keep growing, we think it will be valuable to other operations at Markel to add this knowledge base to our existing efforts in this area.

In aggregate, we produced very good results at Markel Ventures. We enjoyed record results from our cyclical transportation related businesses. Our less cyclical industrial and housing businesses performed as expected.

### Question #1- What is changing at Markel?

As we stated in the opening paragraphs of this letter, the world is changing fast and we are too.

Internally, every change we make is done with the goal of serving our customers better, faster and cheaper. We will do so by continuing to implement and refine our business processes with the latest tools from the disciplines of analytics, technology, communications, and business process systems. At the same time we will retain and build upon the enduring cultural values which bind us together as a team.

Internally, we continue to build upon and improve our successful data warehouse project led by Brad Kiscaden and Mike Scyphers. The data warehouse provides our underwriters, actuaries, and financial professionals, with insights and tools, to improve our day-to-day decisions. During 2015, we also hired Reid Colson to lead our analytics department. We fully embrace the tools of big data and we are using them to increase the speed, granularity, and effectiveness, of daily decision making throughout Markel.

This effort to increase our operational efficiency applies to each and every product, in each and every location, with each and every customer. We are increasing our ability to quickly serve our customers and respond to changing business conditions.

We expect this effort to continue to expand in 2016 and beyond. This is an unending task as the tools and techniques of big data continue to increase in affordability and utility. Simply put, information is king. Every transaction and data point continues to become more robust and informative about what the ultimate risk and outcome will be. We will continue to increase the pace at which we are utilizing these new tools in order to make better, faster, and cheaper decisions.

Another internal development regards the ongoing growth and development of our people. As one example, over the last decade we've periodically conducted an associate engagement process. We use a third party to provide an anonymous feedback mechanism to gain a sense of the issues facing our colleagues and allow them to freely express positive and negative views. Fortunately, we learned that our people profess deep loyalty to Markel and truly value and live our culture on a day-to-day basis. We also learned that they wished for increased training opportunities. We've responded by increasing training options with a greater emphasis on the acquisition of specific skills and techniques as opposed to credentials. This effort will continue.

We continue to grow at Markel. That means our people get to face new and bigger responsibilities. While the names and faces of many of our associates may remain unchanged, they continue to learn and grow and meet newer and bigger challenges. This remains an exciting feature which helps us to attract and retain talented associates.

Externally, we acquired the assets of CATCo during 2015. CATCo, led by Tony Belisle, was an innovator in the creation of Insurance Linked Securities. These securities mark another development in the shifting nature of how capital can be applied to insurance risks. Traditionally, reinsurance was provided by companies with pools of capital that backed general pools of insurance risks. While that model still remains and likely will continue to do so, it is being augmented by techniques and systems that attempt to closely align specific capital and specific risks.

CATCo does exactly that by arranging and managing reinsurance protection for specifically defined risks as well as sourcing and managing capital that is dedicated to this aspect of the reinsurance market. CATCo has already been successful in accomplishing this task. As part of Markel, Markel CATCo will be able to market their products and services in the U.S. as compared to their previous focus on non-U.S. markets. Additionally, with CATCo as part of Markel, we expect to see more global reinsurance opportunities which we can elect to participate in and deploy available capital.

**Question #2- What remains the same?**

Thirty years ago in the first annual report we described Markel as a company with a strategy of specialization and diversification that would apply proven successful principles to grow over time at an ambitious rate. We also reported good results in several divisions of Markel at the time, and one area with disappointing performance.

That same language applies in 2015.

As we said at the beginning of this report, in 2015 we enjoyed excellent profitability in our insurance operations as well as meaningful growth and profitability in our Markel Ventures companies. In our investment operations our returns were below our historical levels and reflected the challenging environment of low interest rates, low overall investment returns, and rapid technological change.

This circumstance is nothing new. Insurance and investment markets cycle back and forth between strong and weak overall results, and technology is always changing. Our record has been built over decades of this reality.

One way in which we've successfully maneuvered through these cycles and technological change is that from the very beginning Markel operated with a strategy of specialization and diversification. Specialization creates the opportunity to develop deep expertise about specific areas. This increases the ability to effectively serve our customers year after year and to build and maintain deep and long lasting relationships.

Diversification serves a dual purpose of allowing us to continue to adapt and grow as different markets change over time and to protect our financial position from the vagaries of any one product or area.

2015 demonstrates the unchanging value of that systematic design as we both enjoyed meaningful profitability from our insurance and Markel Ventures operations while investment returns experienced challenges. At the same time, we pursued internal growth and development across our existing operations and we executed the acquisitions of CATCo and CapTech.

The fundamental business architecture of Markel remains the same. It is a proven and tested model with durability and resilience.

## Continuous Learning

As it says in the Markel Style we've been "striving for a better way" even before we went public in 1986 and we continue to do so today. Continuous learning is how we do this.

Technology and digitalization changes the tools used in this task, not the task itself.

There is no more important idea than that of continuous learning. The tools and methods to conduct business continue to change. As such, we need to rapidly learn and adapt. We need to use the new tools in the realm of analytics, communication, technology, and learning.

We are dedicated to this task throughout this organization and will act to continuously learn and refresh and renew our techniques and disciplines.

While the rate of change issue seems relentless and instantaneous there is one seemingly contradictory factor at work in the middle of this change, namely, the value of a long-term time horizon.

Making decisions tends to be easier and more effective with a long-term time horizon. We frame our choices in the context of seeking the best decisions for the long-term interest of the Markel Corporation. With this frame of mind, we are not trying to artificially make a decision that might appear better for a short time but carry long-term disadvantages. We try our best to measure decisions over appropriate long-term horizons that promote accountability and responsibility, but at the same time recognize that good decisions often take time to achieve the desired effects.

Our incentive compensation systems, most of which measure results over multiple years, work to reinforce and align the priority of long-term economic rationality.

Another factor which hasn't changed at Markel is our team orientation. As we said in the Markel Style, "we are willing to put aside individual concerns in the spirit of teamwork to achieve success." This remains a cultural hallmark of Markel.

In each and every aspect of Markel's insurance, investment, and ventures operations we faced competitive market conditions in 2015. We expect that will remain the case in 2016 and beyond. From a macroeconomic standpoint the ongoing era of very low interest rates has manifested itself in a business environment of low rates of return on capital throughout almost all industries and sectors.

The good news is that in this environment, superior talent and skilled execution will continue to produce the best results possible. That remains true regardless of the overall level of interest rates and investment returns. We are well served at Markel by our focus on the skills, dedication, and ongoing learning commitment of everyone in this organization.

Diversification and specialization also remain constant features at Markel. The good news about diversification is that it allows us to expand and contract certain lines of business depending on the level of opportunity. This is true in various lines and areas of insurance as well as in the investment portfolio, and for the Markel Ventures operations. We have an array of businesses in this company that produce capital and we can reinvest that capital opportunistically across a diverse set of opportunities.

Specialization is important in that it tends to provide both the basis of expertise and the ability to add value and serve our customers. We have a set of deep subject matter experts across many aspects of business. Sometimes they are underwriters, claims professionals, or other insurance professionals who bring true value-added knowledge to their clients. Sometimes, our diverse experts reside within the companies we hold in our investment portfolio. Sometimes, our experts reside inside our distinct and different Markel Ventures set of companies. The great news is that within our many specialized business operations we enjoy a roster of some of the world's best experts. As is always the case, the best experts have the most chance of profitably serving our customers and creating returns for us as Markel shareholders.

Finally, we continue to search for new business opportunities, and new people, in our insurance, investment, and ventures operations. We've acquired new companies over the years, opened new offices and expanded into new locations all around the world. Talented people join and stay with Markel due to both our culture and opportunities to keep learning and growing.

We embrace the new world of faster paced analytics and decisions and the task of increasing our skills to adapt to and shape the future. We also take comfort in the knowledge that talented people with all of the necessary skills will flourish within an enduring culture which celebrates and rewards their efforts in a consistent and meaningful way.

We look forward to reporting our progress to you next year and we thank you for your commitment to the longstanding success of Markel.

Alan I. Kirshner, *Executive Chairman*

Anthony F. Markel, *Vice Chairman*

Steven A. Markel, *Vice Chairman*

Thomas S. Gayner, *Co-Chief Executive Officer*

Richard R. Whitt, III, *Co-Chief Executive Officer*

F. Michael Crowley, *President*

Markel 2016

Steve Markel, Tom Gayner, Richie Whitt (Insurance Operations), Anne Waleski (CFO)

David Winters - Can you grow organically, or do you need to do deals to go from $1k to $2k.

TG - Culture of organization has done a terrific job. Markel Ventures initially labeled inorganic growth. But, over time as it belongs to organization it leads to organic growth. Same for people brought in that do new things. If you're not part of the Markel style, you are unlikely to stay as part of the organization and clarity of the message.

RW - Mix of biz is always changing. Have to be reinventing yourself. Lines of biz change over time. There are areas that you can achieve organic growth. You have to grow that way to achieve success.

Q - What are your criteria for purchasing companies and do they change over time?

TG - Criteria apply to purchasing stock, new biz, insurance biz

- Profitable with good returns on capital. For biz to last and endure it has to be profitable, have enough money to pay its bills, employees, etc. or it will go away. Some legitimate ventures of investing do not require this (such as VC), but that is not what MKL does. Wants to invest in biz that do things for rather than to their customers. Also don't like too much debt
- Biz run by people with equal measures of talent and integrity. Need to be honest and fair in their dealings with customers, employees and shareholders.

- Best biz in world is one that makes good returns on capital and can keep investing it and earning good returns. Have good capital discipline.
- Affordable price.

SM - For MKL, those four lenses are part of their DNA. Unlikely to venture too far from those four tenets. There may, however, be changes in knowledge base over time. We may miss some things, but maintaining focus on them helps eliminate problems.

Q - Views on compensation and structure of incentives and how they are aligned with how they do things.

AW - Incentives are really important. It is true that you get what you invent without question. You can underestimate how much you can get through incentive comp. Thinking about tying people to their performance and performance of the organization. Had historically emphasized individual performance. Gave people who aren't underwriters a people of the company to connect to performance of company.

RW - Underwriting grid. Critical to philosophy and model is to generate consistent underwriting profits in order to make model work. Have capital models to set the pricing. Maintain float. Pay out over time. Each person ends up with a bank (relates to profit over time). Helps increase retention. If results deteriorate, company can also recoup overpayment of compensation over time. Added growth incentive (after underwriting profit is generated) in order to help improve growth of underwriting profit.

SM - Importance of making incentives based on long- rather than short-term results. Want to encourage to think long-term and build wealth.

TG - Markel Ventures. Have people think like owners. Share in profitability of acquired businesses. Get people to think that if this was your money what would you do. Recall, however, that money is not the be all and end all. Really want there to be some element that goes beyond money. Recognition, being part of a team and a culture.

Q - Painful lessons that have been learned along the way.

TG - At MKL, it's ok to make mistakes. Just don't keep making the same ones. None of us are smart enough to not make some mistakes along the way. Try things figure out what you should do more of and what you should not do.

Markel Ventures. Don't always get it right as far as the four criteria go. Learned to have more sensitivity around reinvestment opts for the biz. Management assessment is not always spot on. Have learned it is an entirely diff matter to buy a biz that is already operating to scale, has a team, bench, succession process. Much different than a one-man operation. Have to have more confidence to go with the "one" person show. To say that this hasn't worked as well as you hoped does not mean you stop. You put the gear on and go back to it tomorrow. Try to improve.

RW - Terra Nova acquisition. In moment it was tough, considerable effort required to get it going in right direction. Now it is 1/3 of operations and extremely profitable. Let's learn lessons from this deal and do next one better. Created ability to grow outside the US.

Q - Equity port has provided a tailwind. 125 positions, with bulk in top 10. How do you weigh incremental returns from top positions vs the tax consequences of selling if you think the future performance might be bite served by selling and reinvesting in something else.

TG - Having a big gain is a great problem. May the lord bless us with more of this problem. Does the math. Figures out the tax cost and how much you have to invest in next idea. How much do I have to earn on new idea to weigh and balance that tradeoff. Something they look at all the time. As trajectory levels out, it can increasingly make sense to sell, recognize the gain and move on. Paying a big tax bill is far from the worst thing in the world.

SM - Having large gain and deferred tax is a positive. Find investments worthy of a 5, 10 15 or forever holding period is important. Not going to sell over a rough quarter or two. Will ride it through as long as believe in the long-term prognosis.

Q - Reinsurance biz (WB and CM) don't see it as being that attractive. What did Alterra bring and what do you see going forward.

RW - BRK comments not that surprising. MKL Re writes about 20% of MKL biz (about $1B of premiums). Next number of years, all things being equal, will be tough for reinsurance. Like biz for the long term. Want to continue to be in reinsurance biz. One of great things about it is that there is not a lot of overhead to it. Sitting on hands and not writing a lot of biz or not writing biz is low opportunity cost. Option of having the biz for the long term is an option worth having. For example, you won't see BRK getting out of reinsurance. Stay for the long term may just have to ride the market down for next few years.

SM - WB comments about reinsurance are a little bit unique to BRK. Few companies can say no to reinsurance opts the way that BRK can. There is more capacity in market, so reinsurers now can go to broker and get it placed with 10 companies. Size of BRK biz and what it can take on is different than for others such as MKL; I.e., BRK niche has gotten a lot smaller.

TG - A pancake no matter how thin has two sides. If you had all the money in world and were immensely capitalized would you say good or bad things about it... People hate volatility. Make point of wanting efficient market, etc. There is a strong set of buyers looking to damp down volatility. Reinsurance is volatility reinforcement machine. There is cyclicality to the biz. It will, however, be around for a long time. You can live through the fallow period with very low costs. Have to hang in to do more of it when it is appropriate. It is not quite as bad as you think it is.

Q - How are you using reinsurance given lower rates and lowering own retention ratios.

RW - Want people to be thinking about underwriting profits all the time. Try hard not to game reinsurance. Very strong temptation that as pricing goes down to buy a lot more. Want people focused on generating underwriting profit even with lower premium/volume.

SM - One problem with some companies that try to use reinsurance to manage P&L and operating results, is they are trading reinsurance income for future profits. Sometimes cash can be used in a negative way. Goal is to be there tomorrow and get a fair shake out of the deal. Use less, make money and be there tomorrow.

TG - Want everybody you are doing biz with to feel good about doing biz with you. That is what makes the biz. Quicker to pay people that have provided you good reinsurance biz. Don't get into temptation of buying good reinsurance too cheap.

Q - Why should investors pick MKL over the competition.

TG - I'll bet MKL isn't the only stock you own, and you may own some of our peers as well (as does MKL). As long as you have people that want to be profitable, then you can compete. The problem comes when you have companies that do not look to make a profit.

Q - Is it rational to be a family company?

TG - Yes. Considers himself part of the MKL company. A public company that is privately traded. Like the sense of values implied with we're a family.

RW - Treating associates, customers, and channel partners the way you want to be treated is part of the culture of being a family company and provides competitive advantage.

Q - Insurance side - What is your look at combined ratio, free float,  Are you confident combined ratio will stay positive in low interest rate environ

RW - Headwinds to combined ratio from competitive market. Zero interest rate world makes it harder to get to kind of returns they want. Don't see market becoming less competitive until industry starts to report combined ratios over 100.

AW - Recognizing need for lower combined ratio also impacted by incentive comp. Have to make sure there is a match.

SM - Sophisticated analysis of loan loss reserves has led to a lot more discipline in the industry.

TG - Mix between fixed income, equities, etc. Have to have enough fixed income to collateralize the insurance liabilities. Think about the mix beyond that by focusing on where you get the best returns.

Q - Do you worry about DIS succession plan?

TG - Biz that does require great leader. Mistake he made in DIS, DIS is an example of mistake of omission, which are normally bigger than those of commission. It relates to succession issue after Walt left company and Michael Eisner took his place. The systems and culture they have put in place will likely need to next CEO being viewed as having done a good job. If he doesn't, then they will find someone else who can. Believes DIS is as far along the path as anyone he can think of systematizing creativity.  DIS is one of largest holdings and expects it to remain that way.

Q - Takeaways of panel from yesterday's BRK meeting.

AW - You go to church to reinforce what you already know and think about something different. Spent time watching WB and CM and thinking about amount of energy they muster up every year to do that as well as the related passion.

RW - Their steel bladders as men of their age. Liked chart of operating earnings and related growth over the last 20 years. Ability to continue to build BRK operating earnings power something that MKL is trying to do.

TG - Sense of humor. Not just about a joke intending to get a giggle. They are teachers. They enjoy the benefits that come from being generous. They are meant to teach you a point. Communication, making a point in a vivid way that you can remember.

SM - Occurs to him that MKL Ventures needs to buy something to put on the dais for them to eat. References to personal values inculcated into running their biz. Personal values and corporate values should mesh and serve as important guideposts in running your biz.

Q - How MKL leadership influences MV acquisitions to make sure that they become better companies after joining MKL.

TG - AMF Bakery acquisition - Looked at F/S, Said this is a good biz with bad balance sheet, constraining the biz. Creates a constraint in terms of running the biz and dealing with customers. MKL reduced the leverage. Allows you to take care of customer and make things right. Provide the equipment that makes things work. Helps make the biz better after joining MKL.

Q - Transition to achieving high returns on larger asset base.

TG - Trying to keep size under control. Will do best they can. Different companies have different returns at different stages. Thinks returns will make sense to shareholders. Can't control results only process.

Q - TG Google Talk (look for this). Change from looking at 52-week low to 52-week high list for investment ideas.

TG - Old set of competitive advantages applied to new set of companies. There is not a way back machine only going forward. There are some winner take all markets that exist. Created some sense of natural monopoly. Oftentimes lead by 30-40 year old founders. Could retain that leadership for a long time. Gives biz much more long-term viability. Giving more consideration to adding to such companies. Should they be wrong, they will adjust and reallocate that capital elsewhere

Q - MV. Why would companies choose Markel Ventures over other suitors?

TG - Private equity has a lot of money behind it. Have done fewer of those deals. Only one in last year. MKL was ultimately chosen because company ultimately decided it would be better to be part of MKL than stay outside. Relationships and strategic issues that made sense to both. There may be different environs here having additional money may be more or less important. Will do all they can to have money when others have less or none.

Q - RLI Corp holdings - fair value determination.

TG - Company they admire and have held for long time. Won't provide specifics.

Q - Colfax.

TG - Director and can't comment. Has deep respect for people that run that company.

Q - How do you value quant side of the company?

TG - PV of any company is NPV of net cash flows it will produce over time. What are expectations re: cash it will produce over time. What does it cost to buy it, what will it be worth.

Q - View on looking at synergies or non-synergies.

RW - Strategy for first several decades was to buy companies and allow them to be run pretty entrepreneurially for several decades. Very decentralized. Over time it became more difficult to scale. More centralized in terms of shared services, divisions. Try to provide a lot of autonomy to compete in those markets.

TG - Many functions on insurance side have been centralized such as accounting. On venture side, slightly different. Several biz have nothing to do with one another. It is, however, culturally acceptable for those biz to be run independently without connection to other biz. But incentive comp and culture should be in line with MKL overall philosophy. Their connections to market in different ways will allow for further expansion over time.

Q - DIS - concerns about ESPN. What would it take for GOOG, FB, AMZN to be bigger.

TG - Do not have sports marketplace to itself the way it once did, but it still might be pretty good. Even with those fundamental challenges, If others continue to appreciate, they will grow over time. If they continue to perform, they will increase size.

Q - Biz book recommendation. Valeant thoughts

TG - No comment on Valeant. Book - Millard Fillmore biography. Was much better president than many give him credit for.

Q - Valuing MKL. Returns on capital. ROE five-year average 8%, trading at 1.5x book.

TG - ROE number is probably wrong. Reported ROE over 50 years does not recognize unrealized gains on securities. There is more there and ROE is understated economically. Accounting info only gives you insight.. Some analysts include realized and unrealized gains. Others do not. Agree with CM that as you get the greatest understanding of what the true ROE is, you get the best understanding of what true growth of capital will be. Look at 10 year history (if not longer) and it should provide some guidance as to what may happen going forward.

Q - What do you do with companies that don't have the 10-year history discussed in previous question.

TG - Admit you don't know. You guess. Every day as new info comes in you update your outlook/estimates. Those companies have a lot of cash that came from fundamental operation of the biz itself.

Worry about it every single day and adjust for new information. Challenge of scaling a biz versus operating one at scale.  What is a rational thoughtful way to allocate capital starting today. Under that basis, they hold companies such as GOOG, AMZN

Q -

TG - Biz at scale, parts of biz and product line are not at fast growth. The biz have done all they can do and have 100% market share leads to paying different price than you would get for biz with more growth opportunities.

Q - How do you reassess moat of a company you have held for awhile

TG - General example - world changes. You go to work every day with some degree of paranoia over whether or not it will still be good today. Take nothing for granted.

Q - What is your opinion on Fairfax's put positions?

SM - Prem is very smart guy. Fairfax is very smart guy. Need to ask Prem.

Q - Regulatory constraints investing in fixed income versus equities.

TG - BRK follows and applies same regs as everyone else. But, given their size they have a lot more room to apply equity holdings within their portfolio.

Q - Next possible acquisition

AW - Everyone is looking but increasing profitability and efficiency of what they already own as well. Have applied what they have learned to recent acq's allowing for faster integration of Alterra, e.g.

RW - Have been busy doing smaller deals adding to their capabilities. Feels as good about MV and MKL as ever has. What is the best opportunity. Buying something or building internally. May not always be buy.

SM - Have gotten good at doing acq's. Expect more over time.

# 2016

## To Our Business Partners

Greetings, here is our annual report for 2016. Our long term goal at Markel is to build one of the world's great companies. As the comedian Steven Wright once proclaimed, "My goal is to live forever, and, so far so good." We're delighted to report to you that, "so far so good" describes our progress towards our goal in 2016.

Each year in the course of this report, we share with you some details about the year that was, as well as some of our hopes and dreams for the future. While we necessarily break down our results in the normal pattern of yearly increments, we don't think about Markel in annual terms. We think about your company in two distinct yet completely connected time horizons, namely, *forever* and *right now*.

Those two time frames guide our actions. We believe that Markel remains unique among most publicly traded companies in emphasizing the *forever* time horizon as much as we do. That is an immense competitive advantage for us as we continue to navigate into an always uncertain future that continues to change at faster and faster rates.

We won't sugar coat it. Business, (and life) these days, resembles an all-out, full sprint, winner take all race, to adapt to the changes wrought by technology. We must continuously learn, and adapt to new conditions, adopt new technological tools, abandon obsolete business practices and systems, find new markets, develop new products, acquire new businesses, and succeed at every other challenge you can think of to continue to build Markel.

We mean to do so.

Ironically, we are served immensely well in this task by our dual time horizon culture. The emphasis on *right now* means we need to make appropriate changes and adapt to this way of doing business **right now**! There is no time for cherishing old ways and reminiscing about an idyllic past. (In point of fact, the past was never idyllic; it is just falsely remembered that way

### Financial Highlights

| *(in millions, except per share data)* | **2016** | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|---|---|---|---|
| Total operating revenues | $ **5,612** | 5,370 | 5,134 | 4,323 | 3,000 | 2,630 | 2,225 | 2,069 | 1,977 |
| Gross written premiums | $ **4,797** | 4,633 | 4,806 | 3,920 | 2,514 | 2,291 | 1,982 | 1,906 | 2,213 |
| Combined ratio | **92%** | 89% | 95% | 97% | 97% | 102% | 97% | 95% | 99% |
| Investment portfolio | $ **19,059** | 18,181 | 18,638 | 17,612 | 9,333 | 8,728 | 8,224 | 7,849 | 6,893 |
| Portfolio per share | **$1,365.72** | 1,302.48 | 1,334.89 | 1,259.26 | 969.23 | 907.20 | 846.24 | 799.34 | 702.34 |
| Net income (loss) to shareholders | $ **456** | 583 | 321 | 281 | 253 | 142 | 267 | 202 | (59) |
| Comprehensive income (loss) to shareholders | $ **667** | 233 | 936 | 459 | 504 | 252 | 431 | 591 | (403) |
| Shareholders' equity | $ **8,461** | 7,834 | 7,595 | 6,674 | 3,889 | 3,388 | 3,172 | 2,774 | 2,181 |
| Book value per share | $ **606.30** | 561.23 | 543.96 | 477.16 | 403.85 | 352.10 | 326.36 | 282.55 | 222.20 |
| 5-Year CAGR in book value per share [1] | **11%** | 11% | 14% | 17% | 9% | 9% | 13% | 11% | 10% |

[1] CAGR — compound annual growth rate

because we survived it.) In prior eras the joke was that between faster, better, and cheaper, you could pick any two. Now, that is no longer the case. We need to be able to provide all three.

In the midst of this urgency, we have a profound competitive advantage. Namely, we think about each of the *right now* decisions in the context of *forever*. We're not making decisions for the expediency of getting through one day. We are thinking about them in the context of what is the best decision we can make *today* in order to build the long term durability and profitability of the Markel Corporation *forever*.

We think that very few organizations enjoy this profoundly clear mission and degrees of operational freedom to pursue this goal.

The only reason we remain free to do so is that you, our shareholders, have placed an immense amount of trust in us. We've acted in your best interests over decades, and our record of financial success helps to demonstrate your wisdom in allowing us to do so.

Thank you.

We will continue to do our best to earn this unique level of trust and support.

Turning to the results of 2016, you can think about three distinct yet interconnected economic engines of activity within Markel as you review these financial statements. Those engines are the three I's, Insurance, Investments, and Industrials (Markel Ventures).

As is always the case, the language of U.S. GAAP accounting strives to communicate the economic results of the underlying activities. In the course of this letter, we'll talk about those results as U.S. GAAP would have us present them. We'll also talk about qualitative factors which we hope provide an even greater understanding of where our conditions may be better than what the raw numbers would show, and some areas where we might not be doing as well as it would seem at first glance.

As managers of this business, this is how we think. Numbers provide just the beginning steps on the path to understanding. We want to go further and more fully comprehend the conditions and circumstances our businesses face. We believe that the more we understand, the better our decisions are likely to be.

| 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | **20-Year CAGR[1]** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ 2,551 | 2,576 | 2,200 | 2,262 | 2,092 | 1,770 | 1,397 | 1,094 | 524 | 426 | 419 | 367 | **15%** |
| $ 2,359 | 2,536 | 2,401 | 2,518 | 2,572 | 2,218 | 1,774 | 1,132 | 595 | 437 | 423 | 414 | **13%** |
| 88% | 87% | 101% | 96% | 99% | 103% | 124% | 114% | 101% | 98% | 99% | 100% | **—** |
| $ 7,775 | 7,524 | 6,588 | 6,317 | 5,350 | 4,314 | 3,591 | 3,136 | 1,625 | 1,483 | 1,410 | 1,142 | **15%** |
| $780.84 | 752.80 | 672.34 | 641.49 | 543.31 | 438.79 | 365.70 | 427.79 | 290.69 | 268.49 | 257.51 | 209.20 | **10%** |
| $ 406 | 393 | 148 | 165 | 123 | 75 | (126) | (28) | 41 | 57 | 50 | 47 | **12%** |
| | | | | | | | | | | | | |
| $ 337 | 551 | 64 | 273 | 222 | 73 | (77) | 82 | (40) | 68 | 92 | 56 | **13%** |
| $ 2,641 | 2,296 | 1,705 | 1,657 | 1,382 | 1,159 | 1,085 | 752 | 383 | 425 | 357 | 268 | **19%** |
| $265.26 | 229.78 | 174.04 | 168.22 | 140.38 | 117.89 | 110.50 | 102.63 | 68.59 | 77.02 | 65.18 | 49.16 | **13%** |
| | | | | | | | | | | | | |
| 18% | 16% | 11% | 20% | 13% | 13% | 18% | 21% | 22% | 23% | 26% | 26% | **—** |

This sort of commentary about the numbers is what we would ask from you if our roles were reversed. We think that you as the shareholders and associates of this organization are entitled to the fullest possible communication we can provide in order to understand your ongoing decision to partner with us at Markel.

## 2016 in Review

In aggregate total revenues grew to $5.6 billion in 2016 compared to $5.4 billion in 2015. We earned underwriting profits of $316.5 million versus $429.7 million with a combined ratio of 92% versus 89% the prior year. Net investment income for 2016 was $373.2 million versus $353.2 million, realized gains were $65.1 million versus $106.5 million, unrealized gains were $342.1 million compared to $(457.6 million), and the EBITDA of Markel Ventures grew to $165.1 million versus $91.3 million.

These sum up to comprehensive income of $667.0 million versus $232.7 million and growth in book value per share of 8% for 2016 to $606.30 from $561.23. We are pleased but not satisfied with this aggregate result and economic progress amidst the low overall returns available in current financial markets.

More importantly, our raw 5 year growth rate in book value per share stands at 11%. We measure ourselves on this rolling 5 year metric in order to assist us in thinking about longer term measures of performance. The 5 year time frame is our attempt to create a period of accountability that allows us to absorb normal, short term volatility, yet remain accountable to producing appropriate returns on your capital over reasonable periods of time.

For compensation purposes we adjust the 5 year growth number to account for share repurchases and issuances and back them out of the calculation. We do this to assure that we only pay ourselves for changes in the underlying economic value of Markel, and not for capital market activities.

As always, we present in the first part of this letter a table which shows our key financial statistics, year by year, over the last 21 years. We do this every year, and we think it demonstrates our commitment to long term thinking and accomplishment. Year by year you see the revenues, earnings, investment results and overall returns from your company. Over time, you can see the excellent long term pattern of financial results which validate our approach and provide the foundation for the future of our customers and clients, associates, and shareholders.

## Engine #1- Insurance

In 2016 we wrote total insurance premiums of $4.8 billion versus $4.6 billion, an increase of 4% over the prior year. We produced an underwriting profit of $316.5 million versus $429.7 million and our combined ratio ended the year at 92% versus 89% in 2015.

Conditions across the insurance market worldwide remained brutally competitive. That is true in every product across the board. Despite the ongoing competitive nature of insurance markets we produced an underwriting profit as demonstrated by the combined ratio of 92%. We've been profitable on an underwriting basis in 15 of the 21 years shown on this chart and we hope that provides you with a tangible sense of how much we mean it when we say that we are dedicated to making an underwriting profit. We will continue to exercise discipline, and walk away from insurance risks that in our opinion carry a likelihood of underwriting losses.

We reinforce this focus with consistent incentive compensation practices which provide extra compensation if and only if our insurance operations produce an underwriting profit. No one at Markel gets paid to produce business that we expect to be unprofitable.

As you know, the combined ratio gets its name because it combines two distinct items, the loss ratio, and the expense ratio. In order to produce an acceptable total combined ratio we continue to focus on both aspects in order to produce an acceptable total. Much of what is changing at Markel can be thought of as our attempts to address each of these components.

For instance, part of our growing activities in big data, data analytics, predictive modeling, and other rapidly changing dimensions of technology, relate to improving our loss ratio. At its most basic level, getting better at "data analytics" means that we know more about our customers, and the risks associated with insuring them.

The tools of technology increasingly allow us to analyze and better understand more factors that cause losses. With this increased knowledge and understanding, we can serve policyholders by helping them to reduce risks and we can more accurately price and select the risks we assume on their behalf.

As one small example, our data analytics team partnered with the Wholesale division to create an express renewal process that enabled us to offer automatic renewals to existing policyholders. The underwriting decision can be made at a portfolio level rather than policy by policy with this approach. This improves the customer experience by simplifying the process, and lowers expenses for everyone.

All of this "big data" enabled knowledge allows us to lower the overall cost of risks for our customers and for ourselves. This is a win-win scenario that is consistent with the goal of building one of the world's great businesses by lowering the overall cost of risk in a systemic fashion. We believe a great company does things *for* its customers rather than *to* its customers and this stands as a good example of this belief in action.

Similarly, we continue to focus on reducing the expense ratio. Our aggregate expense levels remain stubbornly high, and we need to lower the expense ratio to remain competitive. Just as is the case with using technology to improve our decision making regarding underwriting decisions, marketing activities, and ultimate claims outcomes, we need to continue to accelerate the use of technology to improve our operational efficiency.

We confess that we wrote these sorts of words repeatedly over the last several years. We write them again because we've not gained sufficient traction against this goal and we need to do better. Increased costs of regulatory compliance, information technology, accounting and finance, human resource activities and general administrative activities along with the associated costs of personnel in all of these areas keep raising the costs of doing business.

We as leaders of the overall business, and each of the heads of these areas, are keenly aware of the need to increase efficiency and lower expenses right now. Despite all of the pressures and difficulties in achieving this goal, we hope to report better news to you in 2017 and beyond. Please rest assured that we are not resting assured.

One of the ways to ultimately increase efficiency and lower expenses will be to use the tools of "Fintech." This is a relatively new word that came into being over the last few years. While it is impossible to contain the full meaning of that word in different contexts, it is not impossible to define it as it relates to Markel. For us, it means that we need to use the tools of technology to improve our underwriting and marketing decisions as well as our operational efficiency.

By the way, this is nothing new. When Sam Markel started this company in the 1930's, there were no computers, fax machines, jet engines, web portals, smart phones, or the internet, among other things. We adapted to those new tools as they came along and we will continue to behave in just the same way as new tools become available.

The goals then, as they are now, were to serve our customers by being better underwriters, and more efficient administrators of the process.

Same stuff, different day.

Throughout 2016, we increased our efforts to improve our knowledge of our business and efficiency in our operations. The language in this letter is that of a layman. Discussions of Information Technology can drift immediately into jargon and unfathomable acronyms, but suffice it to say that we are full at the task of being a digital, and scalable, organization. We are doing so through our ongoing development of in-house resources as well as using external, proven, world class vendors to assist us in this effort.

This crucial task continues to increase in cost and complexity. That said, failure is not an option, and we will continue to iterate to a continuously better outcome. As Michael Jordan remarked, "I've failed over and over again in my life, and that is why I succeed," We continue to strap on our Air Jordans to relentlessly adapt and improve our IT decisions.

## Engine #2- Investments

In 2016 we reported a total return of 4.4% from our publicly traded securities portfolio. For the year we reported a total return of 13.5% on our equity investments and 2.4% on our fixed income securities. For the last 5 years we earned a return of 15.9% on our equity portfolio and 3.1% on our fixed income securities.

We specifically use the term "reported" for the one year number and "earned" for the 5 year term. Those words describe two different, yet related things, and we think it is important to conceptually discuss the nuance meant by using those two different words.

First, the "reported" returns from 2016 are exactly that. These are publicly traded securities, with robust markets, that provide easily measurable marks for how to tote up the market values of these portfolios.

The "reported" amounts represent the absolutely straightforward arithmetic of starting with the market values from the beginning of 2016, accounting for the cash flows in and out of the portfolio throughout the year, and dividing the ending balances by the starting market value. That easily soluble equation yields the answer for the "reported" investment return.

Here's where it starts to get complicated. It's also where it is important to keep going from that reported number, to a more important understanding, of what really happened in investments during the year.

In our opinion, while the equity portfolio enjoyed a reported return of 13.5% for the year, we believe that the underlying economic performance of the businesses we own in that portfolio was probably slightly less than that reported return. Some individual companies performed meaningfully better than what the change in stock prices would suggest, and some performed less well than you might think at first glance. Additionally, the dispersion of economic performance between individual companies, and one industry as compared to another, seems to be getting wider in our opinion. In aggregate, the overall equity portfolio return of 13.5% remains directionally correct in describing the underlying business performance of our investees, but that number is not precise in describing their aggregate economic progress, and we believe it might be just a touch high.

For five years though, the story starts to change, and change for the better. For five years we "reported" a return of 15.9% per year on our equity investment portfolio. We think that number closely describes what we "earned" as well. The point that we are driving home is that this "reported" number is now *more* qualitatively robust, and *more* directionally correct, in gaining an accurate understanding of how we are doing in our equity investment operations.

With the passage of time, the difference between what we "earn" and what we "report" fades away. The year to year volatility in the "reported" amounts dissolve into the reality of what we actually "earn". Five years is not a perfect measurement period to reconcile that difference between the words of "report" and "earn", but it is better than one year. The good news for you is that we as managers think about this over even longer time frames than five years, and act accordingly.

We make the best decisions we can *right now* to create the best *forever* results. (There's that dual time horizon concept at work.)

Please pardon our usual accounting digressions but we believe it is fundamentally important to understand these issues in order to understand how we think, and how we make decisions around Markel. **We care about economic reality more than accounting entries.** We'll go so far as to say that we think that emphasis is somewhat unique, and part of what drives our ongoing competitive advantage.

In our fixed income portfolio the "reported" versus "earned" distinction was particularly wide in 2016. In short, interest rates went up during the fourth quarter of 2016 and the mark to market mechanism caused the price of our fixed income portfolio to fall meaningfully in the fourth quarter. For the full year we reported 2.4%.

We keep a relatively constant duration of between 4 and 5 years in our fixed income portfolio. We also maintain the highest credit quality that we can. We do this in order to collateralize and match our insurance liabilities which have a similar time frame between the time we issue a policy and pay out a final claim.

By doing this, over any given 5 year period, the bond portfolio will roughly mature and get repriced almost completely. Over 5 years, we will "earn" and "report" the interest income from our holdings of high quality bonds and those two numbers will be nearly identical. Our insurance liabilities will have been economically hedged against rising or falling interest rates at each and every point along the way.

The rise in interest rates in 2016 means that our "reported" returns from the fixed income portfolio were lower than our economic returns from owning those securities. U.S. GAAP accounting recognizes that mark to market change of the fixed income portfolio but it doesn't recognize that the net present value of our insurance liabilities decreased economically by a similar amount.

Over five years, these sorts of timing and reporting differences resolve nearly completely, which is why we pay attention to the 5 year number much more than the annual amounts.

By the way… to foreshadow a bit about upcoming U.S. GAAP highlights, over the next several years, accounting rules will change the way in which some of these items are presented. For example, beginning in 2018, market value changes for equity securities, whether realized or unrealized, will flow through directly to the income statement. This will increase the volatility of our reported income, and require some effort to distinguish between what is happening in the recurring aspects of our business, versus normal market volatility in publicly-traded securities. As a result of these new and somewhat confusing financial reports, we expect we will spend more time, as managers, trying to explain what they mean.

The FASB (Financial Accounting Standards Board), and the SEC (Securities and Exchange Commission), along with the IASB (International Accounting Standards Board) have made or are making numerous changes in accounting standards impacting short duration contract disclosures, investment reporting conventions, revenue recognition, lease accounting and various other matters which have the potential to change financial statement presentation and disclosure for us and for most all publicly traded companies. For some of these changes, when they asked us if we thought it was a good idea, or if it would be helpful in communicating our results to our shareholders, or in understanding and managing our business, we opined in our comment letters that it wouldn't.

However, the powers that be said they will change the accounting rules. Bottom line is, we'll be spending more money on the accounting process in the next several years.

As George Bernard Shaw wrote in 1906, "All professions are conspiracies against the laity."

Same stuff, different day.

Rest assured that we as managers will continue to make the best economic decisions we know *right now* for the best *forever* economic outcomes.

As we've written in previous years and repeat today, we continue to follow our time tested four-point approach to selecting and managing equity investments. One, we look for profitable businesses with good returns on capital and low amounts of leverage, two, run by talented and honest people, three, with reinvestment opportunities and/or capital discipline, four, at fair prices.

This approach has served us well for decades. It guides our actions *today* and remains a resilient model that should endure *forever*.

Same stuff, different day.

### Engine #3- Industrials (slang for Markel Ventures...)

Markel Ventures enjoyed a spectacular year.

In 2016, revenues grew to $1.2 billion from $1.0 billion, an increase of 16%, and EBITDA increased to $165.1 million compared to $91.3 million, an increase of 81%.

To provide a similar longer term context for these results consider that 5 short years ago the revenues totaled $317.5 million and EBITDA that year stood at $37.3 million.

Markel Ventures continues to grow as a positive factor within your company. This collection of businesses provides a diversified stream of cash flow for Markel that is not tied completely to the economic fates or regulatory forces affecting our insurance operations.

As such, these cash flows provide resiliency for the company as a whole and allow us more options to consider when we make capital allocation decisions.

Resiliency is a much more important concept than diversification. Diversification is a necessary condition to obtain resiliency, but it is not in and of itself sufficient to achieve that goal.

Resiliency means so much more. Our goal is to continue to build resiliency at Markel. Resiliency means that whatever the markets, and technology, and change, throws at us, we'll be able to rise to those new challenges and circumstances.

Markel Ventures adds to the resiliency of Markel. In 2016, the results from Markel Ventures are both better and worse than what the raw numbers present. They are better in that despite the fact that we earned EBITDA of $165.1 million from the aggregate collection of the Markel Ventures businesses, that number includes a goodwill write off of $18.7 million at one of the companies.

That write-off only occurred because we review each business as separate units that stand on their own for financial reporting purposes rather than in aggregate. As is always the case, accounting treatments and decisions require judgment and different companies often report the same economic realities with different accounting assumptions.

In our opinion, this is a conservative and perhaps unusual degree of self-flagellation in communicating these results to you. Our heritage as an insurance company, and our conservative nature, causes us to emphasize the balance sheet as the most important part of the financial statements. We emphasize redundancy throughout all of our reserving and financial reporting processes in order to make sure we've got a conservative understanding of our balance sheet. This is a good thing, and it serves us well, as we continue to build the resilience of this company.

The Markel Ventures operations tend to be more accurately described by their income statements as opposed to their balance sheets. They also are not particularly capital intensive, and as such, we believe that EBITDA provides a valuable measuring rod to gauge the economic progress of those businesses.

All of that said, after reviewing the current income statements and balance sheets of each individual Markel Ventures company one by one, the decision was made to write down the balance sheet carrying value of goodwill at one subsidiary that is subject to wide economic cyclicality (and we're not at the fun part of that cycle).

As managers, we do not believe that the business is fundamentally impaired. Cycles are merely that, and long cycle businesses can produce volatile results as they progress through the years. This goodwill charge reflects weaker performance for the last few years than before. That performance is highly correlated to energy prices and markets which have been in a fundamental bear market for the last few years.

Neither we nor anyone else knows when or if energy prices will rise or to what degree. That said, the carrying value of this cyclical business has been reduced substantially through this particular goodwill charge. This creates an asymmetric financial reporting outcome. The process creates a one way street where only negative events get highlighted and charged off in lumps. Future good news of better earnings, and the implication of a business that is worth more economically, will never show up in the balance sheet. You'll just see those earnings anonymously comingled with all of the other earnings streams in the income statement. In short, in this one dimension, we think Markel Ventures performed better than the raw EBITDA number would suggest.

"On the other hand," as Harry Truman's economist would say, certain cyclical businesses within the group performed at the high end of what we would expect over the course of a full economic cycle. We do not expect a repeat of that happy event this year, and it would be fair to haircut your sense of the current economic value of Markel Ventures a bit for that factor.

"On the other hand" (and I think we are on hand three at this point), if we owned the economic engines of Markel Ventures through traditional private equity structures of limited partnership form, I am confident that we would be reporting positive "mark to market" valuation changes which would flow through to this year's financial statements. With our structure of direct controlling ownership interests in these businesses, we do not report or rely on any "mark to market" valuation gains in what we think the businesses are worth. In fact the only "mark" we make on the carrying values is when we take a goodwill charge and "mark" things down and never up (see the previous discussion).

By the way, in order to show higher market values on our financial statements, we would have to pay third party management fees to outside managers to do so. Those expenses would be high, and certain. The accompanying reported gains would be uncertain, and the money we would spend to get that accounting treatment would be gone forever.

In our structure, we avoid those high, and certain, external expenses and allow the full economics to flow through to you our shareholders. They show up in the cash flows that you can track on our statement of cash flows.

In this dimension, Markel Ventures is doing better than what it looks like using this year's EBITDA as the measuring rod.

"On the other (and last) hand," the Markel Ventures overall results reflect necessary but "through the looking glass" type purchase accounting entries, internal cost accounting allocations of Markel Corporation overhead, intercompany financing arrangements, and complicated tax allocations. These items all net out to the good for Markel Corporation, but they subtract from the presentation of Markel Ventures' overall economic performance. They further complicate a clear understanding of how these businesses are performing.

The long term good news though is crystal clear and unambiguous. Ten years ago, Markel Ventures reported revenues of $58.9 million and EBITDA of $4.7 million. Five years ago, those numbers were $317.5 million and $37.3 million, respectively. In 2016, they were $1.2 billion and $165.1 million. In the fullness of time, accounting accurately provides an economic report on how businesses are performing. These businesses continue to contribute positively to Markel.

We continue to look for additional opportunities to build the economic value and substance of Markel Ventures. In the current market environment, it remains quite difficult to find attractively priced acquisition opportunities, but we are diligently looking. Stay tuned.

## The Future

Markel remains a unique beast in the corporate world. We think our culture as described by the Markel Style remains a powerful tool to drive the value and the fun of being part of this company.

We will continue to use our capital with the same priorities. As we wrote in the 2013 annual report, "Our first and favorite option is to fund organic growth opportunities within our proven, existing line up of insurance and non-insurance businesses. Our next choice is to buy new businesses. Our third choice is to allocate capital to publicly traded equity and fixed income securities, and our final choice is to repurchase shares of our own stock when it is attractively priced and increases the value of each remaining outstanding share."

Same stuff, different day.

# 2017

## To Our Business Partners

At Markel, we aspire to build one of "The World's Great Companies."

Here is our annual report to you for 2017. In it, we review the year that just ended, as well as our plans and dreams for the future. We try to write everything that we would want to know about Markel if our roles were reversed.

We define a great company as one that serves its customers, associates, and shareholders, consistently and dependably over time. As we do so we grow in every dimension.

We're proud of our record over multiple decades, and we are incredibly optimistic about our ability to continue on this path in the future. The design and components of Markel are unique. Our strategy remains the same as what we stated in our initial annual report as a public company in 1986. Namely, as we said then, "our corporate strategy is one of diversification and specialization."

*We serve customers* anywhere and everywhere around the globe. We do so by providing them with insurance and financial backstops to protect them when unforeseen events create havoc. We help them put Humpty Dumpty back together when things fall apart. We also provide customers with an array of necessary industrial equipment, vital information services, housing, personal products, and healthcare services to help them operate their businesses and live life to its fullest.

*We serve our associates* by operating a "values" based company. The Markel Style describes our unchanging cultural values that we offer to associates of Markel. We provide a home that rewards and celebrates

### Financial Highlights

| *(in millions, except per share data)* | **2017** | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|---|---|---|---|---|
| Total operating revenues | $ **6,062** | 5,612 | 5,370 | 5,134 | 4,323 | 3,000 | 2,630 | 2,225 | 2,069 |
| Gross written premiums | $ **5,507** | 4,797 | 4,633 | 4,806 | 3,920 | 2,514 | 2,291 | 1,982 | 1,906 |
| Combined ratio | **105%** | 92% | 89% | 95% | 97% | 97% | 102% | 97% | 95% |
| Investment portfolio | $ **20,570** | 19,059 | 18,181 | 18,638 | 17,612 | 9,333 | 8,728 | 8,224 | 7,849 |
| Portfolio per share | **$1,479.45** | 1,365.72 | 1,302.48 | 1,334.89 | 1,259.26 | 969.23 | 907.20 | 846.24 | 799.34 |
| Net income (loss) to shareholders | $ **395** | 456 | 583 | 321 | 281 | 253 | 142 | 267 | 202 |
| Comprehensive income (loss) to shareholders | $ **1,175** | 667 | 233 | 936 | 459 | 504 | 252 | 431 | 591 |
| Shareholders' equity | $ **9,504** | 8,461 | 7,834 | 7,595 | 6,674 | 3,889 | 3,388 | 3,172 | 2,774 |
| Book value per share | $ **683.55** | 606.30 | 561.23 | 543.96 | 477.16 | 403.85 | 352.10 | 326.36 | 282.55 |
| 5-Year CAGR in book value per share [1] | **11%** | 11% | 11% | 14% | 17% | 9% | 9% | 13% | 11% |

[1] CAGR — compound annual growth rate

creative, hardworking, talented people motivated by the idea of service to our customers. We are explicit about our commitment to integrity and continuous improvement. Our culture is not for everyone, but it is attractive to those who seek what we offer. We've also found that it applies and works all around the world.

*We serve our shareholders* by producing financial results which reflect our skills at serving our customers and associates. Excellent financial results create the opportunity to grow, to do more, and offer more, over time. Without financial progress, our ability to serve customers and associates disappears.

The 2017 financial statements accompanying this letter provide you with numbers that reflect this year's economic progress towards the goal of "building one of the world's great companies." As is the case with any single year, those numbers tell only part of our story. Over the course of time though, the numbers become more robust and meaningful. They continuously reveal more chapters of the book. The numbers themselves become inseparable threads in a beautiful tapestry. That tapestry depicts the narrative of "building one of the world's great companies."

We're pleased to report to you that we continued to weave that multi decade tapestry in 2017.

Progress did not take place in a straight line in 2017. It almost never does. This report will appropriately discuss the financial impact of the record setting catastrophes that took place last year. Those financial losses should not obscure or diminish the progress we made in the rest of our insurance operations, our Markel Ventures activities, in our investment portfolio, and in the development and continuity of our management team.

At the bottom of the page in this letter we show a table that depicts 21 years of our key financial highlights. The constant and annually recurring review of decades of financial results helps us to remain focused on the long term.

We've made great progress over decades not just in narrow financial terms. Our story demonstrates personal progress and accomplishment for many

| 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | **20-Year CAGR**[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ 1,977 | 2,551 | 2,576 | 2,200 | 2,262 | 2,092 | 1,770 | 1,397 | 1,094 | 524 | 426 | 419 | **14%** |
| $ 2,213 | 2,359 | 2,536 | 2,401 | 2,518 | 2,572 | 2,218 | 1,774 | 1,132 | 595 | 437 | 423 | **14%** |
| 99% | 88% | 87% | 101% | 96% | 99% | 103% | 124% | 114% | 101% | 98% | 99% | — |
| $ 6,893 | 7,775 | 7,524 | 6,588 | 6,317 | 5,350 | 4,314 | 3,591 | 3,136 | 1,625 | 1,483 | 1,410 | **14%** |
| $702.34 | 780.84 | 752.80 | 672.34 | 641.49 | 543.31 | 438.79 | 365.70 | 427.79 | 290.69 | 268.49 | 257.51 | **9%** |
| $ (59) | 406 | 393 | 148 | 165 | 123 | 75 | (126) | (28) | 41 | 57 | 50 | **11%** |
| | | | | | | | | | | | | |
| $ (403) | 337 | 551 | 64 | 273 | 222 | 73 | (77) | 82 | (40) | 68 | 92 | **14%** |
| $ 2,181 | 2,641 | 2,296 | 1,705 | 1,657 | 1,382 | 1,159 | 1,085 | 752 | 383 | 425 | 357 | **18%** |
| $222.20 | 265.26 | 229.78 | 174.04 | 168.22 | 140.38 | 117.89 | 110.50 | 102.63 | 68.59 | 77.02 | 65.18 | **12%** |
| | | | | | | | | | | | | |
| 10% | 18% | 16% | 11% | 20% | 13% | 13% | 18% | 21% | 22% | 23% | 26% | — |

people. It is a composite story of resilience, adaptability, creativity, dependability, and conservatism. And it is a story which carries the implication of continuity and replicability into the future. The story of Markel is one of excellent initial design, and thousands of subsequent actions, ideas, and iterations, which keep our story moving forward every single day.

In 1997 at the beginning of this 21 year chart we reported that we had 830 associates.

As we write this letter, there are over 15,000.

Over the last two decades, 14,000 additional people have joined the ranks of your company. We've built an organization in which our people can grow, learn new skills, take on new challenges, and fully utilize their abilities. We've also created opportunities for more and more people to join us in our quest. A virtuous cycle of serving our customers effectively and efficiently and producing sound financial results while doing so creates this dynamic. "Rinse and repeat", as it says on the shampoo bottle.

It is a joy to report this record of growth over time and we appreciate the associates, the customers, and the providers of capital, who made it possible.

## 2017 Review

In 2017 we produced total revenues of $6.1 billion vs $5.6 billion in 2016, up 8%. Our insurance premiums totaled $4.2 billion vs $3.9 billion, an increase of 10%. Our Markel Ventures operations produced revenues of $1.3 billion vs $1.2 billion, an increase of 10%. We earned 10% on our publicly traded investment portfolio with returns of 26% on our equity holdings and 3% on our fixed income holdings.

We produced an overall underwriting loss of $205 million in 2017 vs underwriting profits of $317 million in 2016 and Markel Ventures EBITDA was $178 million in 2017 vs $165 million last year. In total our comprehensive income was $1.2 billion in 2017 vs $667 million in 2016 and we repurchased $111 million of our own common stock during the course of the year.

When we write this letter, we look back at previous letters to give us a sense of how we've talked in years past. It is easy to see words and phrases such as "transformational", or "watershed events" in previous annual reports. If we knew then, what we know now, we might have saved those words for years like 2017. We hope by the time you finish reading this report that you'll understand why we are using those words again.

## Here are the headlines from 2017:

1- 2017 broke the financial record for the highest ever total level of insured catastrophes. Hurricanes Harvey, Irma, Maria and Nate, along with wildfires in California, earthquakes in Mexico, cyclones in Asia, weather and crop damage in Europe, and other events caused record financial losses

2- We acquired SureTec and State National in our insurance operations

3- We acquired Costa Farms in our Markel Venture operations

4- We made these substantial acquisitions on our base of internal equity capital and each share of your Markel stock owns a bigger business than it did a year ago

5- We worked diligently to improve the efficiency and effectiveness of our existing and new operations
6- We earned record returns in our investment operations

In total, your company grew by roughly one quarter in total size and scale during 2017 with major acquisitions in our insurance and Markel Ventures businesses. We responded to, and served our insurance customers effectively as they experienced record natural catastrophes, and we earned record investment returns.

2017 stands as a transformational and watershed year for Markel (yet again).

Taking each one of these items in order, here is a review of the headlines.

## 1- CATS, CATS, CATS

We wish that we were talking about internet videos with this headline but unfortunately that is not the case. In the insurance business, catastrophic events get described with the shorthand term of CATs. 2017 set a new high water mark for the record books. Financially, the insured loss toll exceeded every other single year in human history.

Total industry losses from hurricanes Harvey, Irma and Maria along with the wildfires in California, earthquakes in Mexico, cyclones in Asia, and European weather events, currently are expected to exceed $135 billion. As such, it is not surprising that our losses from these events also set a new record. We paid out claims of $159 million in response to the catastrophic losses suffered by our customers, with total expected losses of $565 million. Across all our lines of insurance coverages we paid out $2.2 billion in 2017 to help our customers recover from difficult events.

The good news is that these payments demonstrate that our customers can count on us in their time of need. This is why people buy insurance in the first place. It also speaks to why we manage Markel in a conservative and prudent way. We do so in order to have the ability to respond quickly, and appropriately, to help our customers get back on their feet. We keep our promises.

In each and every period of heavy catastrophes, we've learned something about how to improve our operations. We've learned how to better select and accept risks, and how to price those risks more appropriately. It is important to note that despite the large dollar amount of our losses in 2017, those amounts were in line with our estimates of what we expected in the event of major catastrophes.

As we continue to offer insurance to our customers to protect them in the event of catastrophic events, we continue to iterate and adjust our prices and exposures. If events become more common and more costly, we adjust our prices accordingly, to maintain the financial resources needed to pay claims when they occur.

We also provide coverage and protect our clients more efficiently and cost effectively than they could on their own. We do so by maintaining a spread of geographically dispersed exposures. Events in one area tend not to affect other geographic areas. By collecting and managing a pool of insurance risks and premiums from all around the world, we can effectively offer protection and insurance to individual policyholders at an efficient cost to our policyholders. The geographic spread, in and of itself, creates an efficiency that allows us to offer protection to our clients at a lower cost.

Great companies do things "for their customers" rather than "to their customers" and our ability to efficiently operate a diverse pool of catastrophic risk creates the ability to serve our customers better and more efficiently than they could do themselves.

### 2- SureTec and State National Acquisitions

During the course of 2017 we acquired SureTec and State National. These two additions represent new and substantial venues to continue our longstanding strategy of specialization and diversification. SureTec brings specialized knowledge of the surety market, a unique and critical insurance function, which we previously had not been able to offer to our clients in a meaningful way. State National also brings new skills and specialized insurance services with their historical knowledge of certain insurance management and program services, as well as collateral protection products.

Both companies are experts and leaders in their respective fields. By joining Markel, both companies will be able to increase the amount of business they write, add specialized knowledge to better serve our clients, and help us continue on our path of diversification. The diversification adds margins of safety to our financial strength and performance, which stands behind our promises to our clients.

Both companies contacted Markel when they considered their own futures. Our longstanding reputation and performance in helping companies flourish and grow, and our culture of integrity and continuous improvement, created the opportunity for us to engage in discussions with both firms.

In the case of SureTec, the founder John Knox, contacted us directly, as he believed that Markel would offer the best option for SureTec and its associates to grow and continue to build the value of the firm.

John and his team did a wonderful job of launching SureTec in 1998 and growing a successful surety operation. SureTec's largest markets are in their home state of Texas, along with California. While they do business in many other states as well, as part of Markel, they will immediately be able to expand the distribution and awareness of their surety products to Markel's existing nationwide client base.

We already do business with many of the agents, contractors, and current and potential customers of SureTec, and our ability to help them grow through access to our distribution channels and customer base creates a win-win situation for SureTec and Markel. John and his SureTec team win by knowing that their firm will be part of the permanent capital structure of Markel. They can grow and provide long term potential for their current and future associates with the larger and long term base of Markel capital.

We at Markel win by adding surety to our array of insurance products and services. Surety requires specialized expertise and we can serve our customers more fulsomely by adding the surety skills that are now part of Markel.

State National also stands as a strategically valuable and important addition to Markel. The Ledbetter family built State National over two generations. They provided two primary lines of business. In one line, State National served as a "fronting" company for other property and casualty insurance companies. In the other line, they offered collateral protection insurance that works to protect credit unions and their customers.

In the fronting business, State National often works with insurers experiencing some vulnerability, or risks, to their ratings and marketplace acceptance. State National would stand in the shoes of their insurance company clients, and provide services and assurance to regulators and rating agencies, that the client insurance companies could, and would, maintain appropriate levels of service and financial stability.

In developing the skills to provide these important services, State National also developed the skills to assist the growing "Fintech" and venture capital funded entrants in the insurance industry. These new participants often have unique marketing skills, risk pricing abilities, and product packaging and design approaches. At the same time, they often do not have the array of licenses required to offer insurance products or financial strength ratings to provide comfort to potential buyers.

State National can work with those firms to solve their challenges of regulatory and financial rating agency requirements. By partnering, State National and the newer entrants into the insurance business can combine to offer new and unique insurance products that are fully and appropriately regulated, and reviewed by government and rating agency personnel.

As part of the larger Markel organization, State National can continue to expand the size and scale of their offerings and we can learn about the ways in which technology continues to change the fundamental nature of insurance pricing, marketing, and distribution. This acquisition adds additional sets of specialized skills to Markel and further diversifies the set of products we can offer our customers.

### 3- Costa Farms

Costa Farms is the largest grower of houseplants in the world. You can find their plants on the shelves of the leading home improvement and general merchandise retailers as well as online. The company is in its third generation of Costa family leadership and generation four is in the building.

The Costa family demonstrates everything that can be wonderful about a family business. In their words they talk about the foundation of "customers, culture, and growth." With that focus, starting from scratch, three generations built a wonderful business. They work each day to make themselves indispensable to their customers, and they keep a long term focus. All of these activities stem from, and go hand in hand with, building a business that you expect to continue into future generations. Short cuts, and short term time horizons, have no place when this mentality pervades your business.

Just as is the case at Markel, this mindset goes beyond people with the same last name or blood lines. Family becomes a matter of choice as associates join a firm and choose to live with the same long term values.

To be an associate of Markel is to be a member of the "Markel Family" in a figurative sense. We all share the same basic values and commitment to long term success. We were pleased that the Costa family saw this culture at Markel and sought us out as partners to help them to continue to build their business in the future.

Costa stands as the largest acquisition to date for Markel Ventures. They have the specialized knowledge and skills to grow more than 100 million plants per year in varied locations, and get those living, breathing products onto store shelves, or delivered to your home and office, all around the country. They are the leading firm in their industry, and we expect that they will continue to grow organically (please pardon the pun) and inorganically. We provide capital, and a time horizon, that matches the generational views of the Costa family.

The Costa acquisition represents a new level of size and scope for Markel Ventures. We are excited to continue to add specialized knowledge and skills to Markel and to provide additional margin of safety to our customers, associates, and shareholders.

## 4- Acquisition Financing

I'm pleased to report to you that we paid for the acquisitions of SureTec, Costa, and State National with cash. We issued no dilutive equity to fund these purchases. These deals increase the size and revenue footprint of Markel by about a quarter. This is a substantial increase in our size and scale, and we were able to pay for these purchases without additional equity financing.

At the same time as we funded these acquisitions, we began making record levels of claims payments to our policyholders from the CAT losses and normal insurance operations. We believe this combination of activities and events stands as strong evidence of our financial strength, investment excellence, and conservative financial practices. We were in a financial position to pay record claim losses and execute *three* substantial acquisitions all in the space of the same year. Additionally, our financial position enables us to fully seek and accept property insurance risks in the post CAT environment of higher pricing and prospectively better financial returns.

We work every day to build and protect our financial strength. Those daily activities over many years paid off in 2017 as demonstrated by our ability to take advantage of these opportunities to grow.

Separately, we raised $300 million of 30 year fixed rate financing at 4.30% in the fourth quarter. We believe that the ability to lock in such a long term, fixed rate debt makes prudent financial sense and is consistent with the conservative way in which we manage our financial affairs.

## 5- Operational Developments

Amidst the headlines about the new things that happened at Markel this year it can be easy to forget about the thousands of operational details and improvements that took place in all of our global operations.

In each and every aspect of our insurance and industrial businesses we worked diligently to improve the efficiency by which we serve our clients. We have and continue to focus on using all of the tools in the toolbox labeled "technology", to build and maintain our competitive position in the world.

In 2017 our expense ratio stood at 37% compared to 39% in the prior year. This progress shows results from our ongoing efforts to increase our internal efficiency and offer our customers the best possible value for their insurance needs.

Our overall combined ratio of 105% reflects the record amount of CAT losses. CATs in total added 13 points to our combined ratio and the change in UK government mandated discount rate applied to our run-off UK auto business added two points to the total.

We remain fully committed to the discipline of underwriting profits. Our long term record of consistency with this goal stands as evidence that we mean it and we fully expect to produce underwriting profits in 2018.

Throughout the organization we continued to increase the tools created by technological developments. We changed the way we offered renewals to existing policyholders, we streamlined internal accounting and financial processes, we adapted our claims process to reflect more granular understanding of policyholder losses, we increased the efficiency and effectiveness of our marketing efforts, and so on and so on and so on.

There are no activities within the Markel organization that are not being actively worked on to be made better. As it says in the Markel Style we look for "a better way to do things." The most important aspect of that statement is the mindset of continuous improvement that infuses the people of Markel. The tools and technology we use to make that journey change over time but the path is one we've been on for decades. We commit to remaining on that path to improvement in every facet of your company.

There are no businesses on planet earth that do not face the same challenge. Any degree of complacency or satisfaction with current processes or ways of doing business has no place in today's world. There are no elements of any aspect of Markel, in any business, in any country, that are not constantly being refined, reviewed, analyzed, changed and adapted to remain relevant in 2018 and beyond.

### 6- Investment Results

We earned excellent returns in 2017. We earned 26% on our publicly traded equity portfolio and 3% on our fixed income holdings. The total portfolio earned 10%. In dollar terms, we earned more than $1 billion of unrealized gains, realized gains and dividends from our public equity holdings and this represents a new record.

The double barreled win is that we also achieved this performance at a cost lower than passive index funds. We manage the vast majority of our investments internally. The total cost of our in house management stands at a single number of basis points.

We believe that we manage our investment operations with a triple play advantage of, ultra-low costs, tax efficiency, and rigorous and continuous intellectual engagement and management of our portfolio holdings. Two of those three aspects are currently popular in the investment world. Specifically, indexing and passive investing are relatively low cost and tax efficient. With our internal management, we keep our costs lower than passive indexers, we operate with tax efficiency, AND, we obsess about what we own and why we own it. We do so in order to attempt to adapt and change as the world changes.

Our multi-decade record of outperformance in our investment results speaks to the effectiveness of our approach.

As we've written every year since 1999 we maintain a four step approach to selecting and managing our equity investments.

1- We look for profitable businesses with excellent long term returns on capital and modest leverage

2- We look for management teams with equal measures of talent and integrity

3- We look for companies that can reinvest their earnings at high rates of return and/or demonstrate skill in acquisitions or other capital management activities

4- We look for these investments at reasonable prices which should produce acceptable returns over time

That approach and formula has not changed since our initial public offering in 1986 and despite the swirling pace of change in so many aspects of life, we believe the philosophy remains completely relevant and durable. We continue to find productive ways to invest our capital. In the short run, anything can and will happen and results will be volatile. In the long run, we've earned spectacular returns with this time-tested approach and we're confident in our ability to continue to do so.

In our fixed income operations we maintain the highest possible credit quality holdings we can find. We match the duration and currencies of our holdings to our expectations of our insurance liabilities. This has been our longstanding and consistent practice and it has served us well. We also believe the approach is low cost and durable in the future.

In total, our net unrealized gains from this longstanding approach stood at $3.7 billion at year end. With the change in the tax law that occurred during the fourth quarter of 2017, we reduced the deferred taxes associated with these gains and increased shareholders equity by $402 million due to the reduction in the U.S. corporate tax rate from 35% to 21%.

## Next

The spectacular news about Markel is that there is always a chapter that starts with the headline NEXT.

From the very beginning of our firm, with Sam Markel's creative solution to a customer need, the entire history of this company has been figuring out what to do next.

We've done so by following the precepts of the Markel Style. As the Style says, we've worked hard. We've pursued excellence, we've kept our sense of humor, and we've adhered to a creed of honesty and fairness in all our dealings. We've done so on a daily basis for years and we will do it the next day as well.

We tested our design and fundamental strategy of specialization and diversification in 2017. While a record amount of catastrophic losses took place worldwide, our insurance operations were able to absorb those losses. At the same time, our investment and industrial operations produced excellent financial results, and we maintained overall comprehensive profitability for the company. We look forward to the next results from our varied operations as we expect them to reveal the same story of long term progress.

We followed our process of using our financial resources to support organic growth in our existing businesses, acquiring new companies, adding to our investment portfolio of publicly traded securities and repurchasing our own stock. We will follow those same four steps next year and the year after that.

2017 indeed stands as a transformational year in our longstanding goal to build one of "The World's Great Companies." There have been transformational and watershed years in our past and we aspire to more in the years to come.

Next.

Respectfully submitted,

Alan I. Kirshner, *Executive Chairman*

Anthony F. Markel, *Vice Chairman*

Steven A. Markel, *Vice Chairman*

Thomas S. Gayner, *Co-Chief Executive Officer*

Richard R. Whitt, III, *Co-Chief Executive Officer*